

Tax Executives Institute Conference
Washington D.C.
19th March 2007
Key Note Speech
By
Jeffrey Owens
Director, Center for Tax Policy & Administration
OCED

It is an honour to be invited to this conference. The TEI is an organisation which has provided more than six decades of service to the tax community. In today's complex and rapidly changing environment, the TEI's role in training, in advocacy and in promoting a dialogue between business and government has never been more important.

I want to use my 25 minutes to give you an international perspective on the debate over tax and governance.

I – The changing landscape

The landscape within which we tax experts work has changed dramatically. Tax has ceased to be something that just interests tax directors. The press is taking an increasing interest in tax issues. Newspapers such as the Financial Times and the Wall Street Journal now run front page headlines on the way some companies have been targeted over tax avoidance, or the intention of a company to shift its headquarters offshore.

Non-governmental organisations are also more active in the tax area. We have seen respectable organisations such as Oxfam and religious group like Christian Aid (their motto is "there can be life before death") putting out reports on the impact of tax havens on developing countries, or on what should be the tax treatment of private equity funds.

And, of course, as the press and NGOs come into the act, so we find politicians discovering the vote-pulling power of proposing measures to address the tax gap.

So today, there is much more public debate on what we may see as a technical issue. But it's not just that we have a more public discussion. The environment in which we operate has changed:

- Increased global competitive pressures are continuing to force corporations to become more efficient. Tax departments are under pressure to reduce their effective tax rate and today's global environment provides more "creative" ways to achieve this. Corporate business models are changing and tax departments are striving to align their tax strategies with these new business models.
- Revenue bodies are under more pressure to deliver higher tax yields. Politicians have realised that closing the tax gap is a political winner (who would object to better compliance! – only the non-compliant and perhaps those concerned with compliance costs).

- We have also seen many revenue bodies respond to aggressive tax planning by stepping up aggressive enforcement and international tax cooperation. Commissioner Everson has identified this as one of his priorities for this year.
- Also in the light of recent corporate scandals – Enron, Parmalat - financial reporting requirements have been reinforced (e.g. SOX and here in the US).
- And, of course, we have seen international tax rules becoming more complex. For example, today there are more than 40 countries which have followed the US lead in transfer pricing: complex legislation, backed up with heavy information requirements and penalties. This puts a heavy compliance burden on companies.

Some companies have concluded that in this new, more open environment, tax is too important to leave to the tax department. It's been elevated to the Board level which, in turn, has put more pressure on you, the tax director.

In some countries, the outcome from this new environment is that it has become more difficult for a company to predict its tax position. The greater willingness of revenue bodies to challenge a taxpayer's tax position, the spread of general anti-abuse provisions, the imprecise nature of guidance in such areas as transfer pricing, the failure of governments to match the speed of change in the business sector, all these factors put new pressure on companies and their advisors to devote more and more resources to ensure that they have identified correctly their tax position. All of these factors create a climate of insecurity and whilst advanced rulings and APAs can help, they are limited to a relatively small group of taxpayers because of the resource constraints of revenue bodies. We need to explore new ways in which taxpayers and revenue bodies can interact and I believe that the OECD's FTA is an ideal vehicle for this dialogue.

II – The response of corporations

I want to focus on how European companies have responded to this new environment.

In 2005, almost half of the top UK companies' Boards did not have a documented tax strategy and almost 60% had not had a discussion of tax issues in the Board over the last 2-years. This is remarkable when you consider that tax is the third or fourth largest single "cost" category for most corporations and can carry substantial reputation risk. Does the 3-letter word just turn Boards off? Is tax just too difficult to understand? Or did the tax department quietly discourage the Board from getting too involved in "their" affairs.

I believe that if the same survey were to be undertaken today, we would see a significant increase in these percentages. More and more corporate Boards are trying to develop an explicit tax strategy. For those Boards that had discussed tax, just under half described their tax strategy as conservative or risk averse. Only 1% was prepared to adopt an aggressive tax strategy and a third a medium risk strategy. Again I suspect that today we would see more corporations saying they would adopt a conservative approach to managing their tax risks.

When you look at the companies with an explicit tax strategy, these tend to emphasise that the tax strategy must be an integrated part of company's overall commercial strategy and must take account of the potential impact on the company's reputation with its customers, shareholders,

employees and government. Some even go so far as to add: and the tax strategy has also to be consistent with the company's stance on corporate social responsibility.

Corporations have also responded to this changing landscape by reviewing how they account for tax in their published statements. Many now provide more information on their tax liabilities and assets than in the past.

So what are the aims of the tax directors today? Clearly, an overriding objective continues to be to minimise tax liabilities so as to produce a competitive effective tax rate. But this desire to minimise tax will normally be tempered by the need to achieve a stable and sustainable tax rate. Achieving this should reduce the amount of time that senior management has to spend on resolving tax disputes with the revenue bodies (and also reduces reputation risk and reassures markets – when Google dropped its profit forecast because of a tax issue, \$20 billions was wiped off its stock value). The tax director will also want a tax rate that he can explain (justify) to the revenue authorities, to shareholders and to market analysts. For example, how did Enron explain to the IRS that its reported net income from 1996 to 1999 was \$2.3 billion, but its tax losses were \$3 billion, or why it paid \$88 million on fees to advisors' and promoters?

Some have suggested that the tax director should also aim for a responsible tax rate. It is unclear what this means. Responsible vis-à-vis who - shareholders? Government? Society? Or does this imply some concept of a company paying its fair share of the cost of services provided by government (and if it is then account has to be taken of the payroll taxes, property taxes and consumption taxes paid by corporations)? Clearly, each of these stakeholders may have different interests and therefore Boards need to decide what should be the trade-off between them.

I believe that Boards need to devote more time to formulating their tax strategies and should move outside of the narrow perspective of just achieving at one point in time the lowest possible effective tax rate. For example, Vodafone – the major European telecommunication firm - has a published Tax Code of Conduct which begins by saying that Vodafone is not able to determine the "fair" amount of tax that it should pay. It sees its obligation to pay the legally due tax, since minimising tax is seen as part of the process of maximising shareholder value. It then goes on to qualify this statement by taking about the risk that may be associated with any tax strategy: risk of challenge by the tax authorities; risk to relationship with government and with NGOs and risk to the company's reputation. So while the main objective is to maximise shareholders' value, Vodafone will keep an eye on avoiding long-term reputation damage.

Part III – The Response of Government

Just as corporations are subject to competing pressures, so are governments. On the one hand, they want their fair share of revenues; on the other, they want to maintain a competitive tax environment.

So what we have seen over the last 5 years is that countries have been slashing their corporate income tax rates – Germany has just announced almost a 10 percent point reduction. Top personal income rates have also been cut with few countries now having rates above 40%. The US is lagging behind in this downward trend in headline rates. A top pit rate of 30% clearly

provides a greater incentive to avoid paying tax than the rate of 19% you find in Slovakia or 12.5% in Ireland.

At the same time, governments have been putting in special tax regimes targeted at very mobile activities. Singapore, Switzerland and Ireland, for example, have attractive regimes for R&D, services and other intangibles, which is why you find almost 20% of US intangibles held in these jurisdictions.

Countries have also recognised that they need to provide more certainty for taxpayers (which explains the spread of APAs, CAP's, advance rulings). Policy makers also recognise that they must address the compliance cost of taxes (the OECD has just launched a study on this issue).

Governments will expect, however, that as they give taxpayers a more reasonable and more stable tax regime, there should be better compliance. Better compliance requires that the tax authorities provides a better service to the taxpayers – making it as painless as possible to pay tax – and at the same time better enforcement (i.e. increasing the risk of getting caught is of critical importance if we are to maintain taxpayer confidence in the integrity of the system). Commissioners also recognise that they must take tax issues to the Board room. The Australian Commissioner wrote in 2004 to the CEOs of major companies emphasising the role of the Board in identifying corporate risk and that tax is a potential major risk for any company. Interestingly, the Commissioner went on to say that it was not the role of the revenue bodies to advise Boards on how much risk a company should take, but it was important that the Board identified the tax risk – reputational and financial – and decided from the perspective of the whole company what were acceptable and what were unacceptable risks.

We have also seen a new emphasis on developing sophisticated risk management techniques which enable revenue bodies to direct their resources to high risk areas and taxpayers (something that lower risk taxpayers should welcome). But tax authorities – even in big countries like the US – have also recognised that in a global business environment, they need to step up their international cooperation.

Exchange of information is one of the most effective way in which tax authorities can cooperate to counter international tax abuse.

Last year, the OECD issued a new state-of-the-art Treaty Provision on Exchange of Information (Article 26). This has now become the benchmark for bilateral treaties around the world. We have seen the development of new forms of EOI and an increased use of spontaneous exchange. Also as practical barriers to achieving effective EOI have been removed, so the speed with which information is flowing has accelerated.

The OECD has agreed with all of the major offshore financial centres a set of transparency and EOI standards. These form the basis for the 13 TIEAs that the US has negotiated. Currently, 23 of our Member countries are negotiating TIEAs with over 17 offshore centres (Australia and New Zealand last week signed a TIEAs with the Netherlands Antilles).

Initially, this increase in cooperation may be painful for taxpayers – particularly non-compliant taxpayers - but in the long run, I believe it will be in the interest of taxpayers. Better

international cooperation will lead to more consistency in the application of tax rules, more certainty, fewer disputes and, hopefully, more effective measures to deal with disputes when they arise. The OECD has a key role to play in achieving these goals and only last month we issued 25 best practices for Mutual Agreement Procedures and proposals for Mandatory Arbitration (on our website).

Better cooperation also requires a better dialogue between Commissioners. To facilitate this dialogue, the OECD created in 2003 the Forum on Tax Administration. It's a unique forum which brings together Commissioners from OECD and major non-OECD countries. Its agenda covers both the provision of better taxpayer service and better enforcement. We also created a group to look at aggressive tax planning. These international initiatives have been complemented by a number of informal groupings:

- The Joint International Tax Shelter Information Centre (4 country grouping)
- The Tax Haven Group (7 country grouping)
- The LEEDS CASTLE Group

One of the most significant outcomes from the FTA is the Seoul Declaration issued last September. What did the Declaration say?

- There was a shared perception that dealing with non-compliance was a growing challenge.
- Commissioners were also concerned at the way certain tax intermediaries were aggressively pushing tax shelters and other schemes (historically difficult – certainly here in the US - to deny although I think we have moved on, at least for the moment).

What did the 35 Commissioners see as the way to reverse the trend to non-compliance?

- As Kevin said yesterday, you can't audit your way of non-compliance, so revenue bodies have tried a variety of approach
- Part of the answer is to get tax authorities to share information in real time on new tax shelters
- Part of the solution is to put tax as part of the good corporate governance agenda and to get Boards to take more ownership of their tax strategies and to be more aware of the reputational and financial risks associated with any strategy. We are currently working on how to apply the OECD principles of good corporate governance to the tax area
- Improved risk management techniques are also seen as offering a high pay-off
- Commissioners also recognise that they need to intensify their training of tax officials so that they have a better - and shared - perspective on new business models.

The outcome from Seoul that has generated most debate was the decision to launch a study on the role of tax intermediaries (accountants, law firms, investment banks etc.) in the operation of our tax systems.

The study's overriding objective is to build up trust between the revenue bodies and taxpayers. As Chairman Rangel emphasised this morning, little can be achieved without trust. We will do this by

:

- Developing a better understanding of the role of tax intermediaries in the functioning of our tax systems
- Strengthening the relationship between intermediaries and revenue bodies

Throughout this project, there will be a dialogue with business.

What will be the outcome: some principles that can guide tax authorities in their relationship with intermediaries and guide intermediaries in their relationship with their clients. Already we have begun to identify what each side has to gain from a more constructive and a more trusting relationship.

Business could gain:

- Greater consistency in the application of the laws
- Greater certainty: with tax administrations endeavouring to provide clearer rules, a greater willingness to provide advanced rulings, speedy responses to new issues
- Low-risk business would also gain recognition that it's commercial considerations and not tax that primarily drives business decisions.

Revenue bodies could gain from:

- A greater willingness on the part of taxpayers to disclose information on new business products and models at an early stage
- A willingness not just to adhere to the law, but also to the policy rationale that lies behind the legislation
- An alignment of the risk based strategies of revenue bodies and taxpayers
- A greater willingness on the part of taxpayers to be involved in the process of policy formulation and drafting legislation.

When you look at this list, you can see the overlap between gains for business and gains for revenue bodies. A true “win-win” situation. These shared benefits centre around greater certainty, greater transparency and greater cooperation.

Concluding comments

The debate over tax and corporate governance, over tax compliance more generally and over the need to ease the compliance burden on business will continue. The key question for me is how can governments around the world work together to resolve these issues and how can the tax community be part of that dialogue.

I believe that the OECD's FTA provides a good platform for this dialogue and that it must explore new ways of engaging business. I also believe that by bringing together Commissioners from 40 different countries, we will be able to identify a set of best practices by which revenue bodies can structure their dialogue with business. There is no silver bullet but there are lessons – both positive and negative – that can be learned from the experience of difference countries.

What would I see as the issues for such a dialogue? There are a number:

- How can we collectively encourage a more informed debate over tax issues by the Press and NGOs? Organisations like the TEI have a key role here.
- How can we, the tax community, help Boards, audit committees, rating agencies and financial analysts get a better understanding of the role of tax in the management and performance of companies?
- How do we reconcile the often coercive language of the audit side of revenue bodies with the more facultative language of the service side?
- How can the business sector increase the awareness in revenue bodies of changing business models and their implication for tax strategies?
- How can we reconcile the need by business for greater certainty and predictability on their tax positions with the tendency of revenue bodies to increasingly challenge the position taken by companies?
- At a time when many governments are cutting back on the resources of revenue bodies, will they have the funds to provide this certainty not just to a small minority of taxpayers but to the vast majority?
- How do we get greater consistency in the application of the international tax standards established by the OECD, particularly in the area of transfer pricing? Are governments committed to following such rules?
- How do we balance the legitimate needs of governments to design robust compliance measures against the cost such measures imposed on business?

To resolve these issues will require an unprecedented level of cooperation between governments and between governments and business. This will not be easy to achieve, but few would question that it's a goal worth aiming for.

