**ICGN**
International Corporate Governance Network

# ICGN Viewpoint

**Corporate tax policy and arbitrage**

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## The issue

Tax frameworks in differing jurisdictions allow for legal, but potentially dubious, tax arbitrage possibilities. Conflicting regulatory regimes provide opportunities for companies to adopt tax policies to exploit these arbitrage opportunities in ways that may not be regarded as ethical or socially responsible.

On the other hand, companies do face contradictions. At the same time as governments are engaging in “tax competition” (amending their rules and lowering rates to attract international business), these governments are criticising companies for taking advantage of low foreign tax rates.

The ICGN is monitoring the work of the Organisation for Economic Co-operation and Development (OECD) and the G20 in this area including progress on the “Action Plan on Base Erosion and Profit Shifting” (BEPS) initiated in St. Petersburg in September 2013 to coordinate government action. Additional disclosures of a company's tax payments on a country-by-country basis have become a feature of the extractive sector through initiatives such as the Extractive Industry Transparency Initiative. Moreover, the OECD is exploring issues relating to having country-by-country tax reporting implemented for companies in all sectors.

Until there are changes in tax laws that eliminate existing loopholes, investors should hold company management and boards accountable for a company's tax policy to ensure that the company is not only acting legally, but within the bounds of acceptable social norms. This is primarily achievable by assurance in the form of public disclosures that oversight of tax policy comes under the purview of board oversight. Tax policies themselves should be sufficiently prudent to stand up to external scrutiny on a sustainable basis.

## Investor position

For investors, corporate tax arbitrage can present a quandary. On the one hand, tax efficiency, managed legally, can bolster profitability, at least in the short term. On the other hand, reputational and commercial risks can present themselves at companies that are in fact, or perceived to be, abusing even legitimate tax obligations.

In some cases, short term benefits of tax efficiency might have longer term commercial consequences by negatively affecting brand value and stakeholder relations (customers, employees, civil society, governments, and regulators) that are critical for a company's long-term success. In extreme cases, negative consequences could affect a company’s license to operate.

Investors have a stake in the evolving 'responsible tax' debate in at least four respects:

1. as owners of companies that in turn pay tax, investors have a vested interest in any corporate activity affecting profitability;

2. reputational and commercial risks arising from aggressive tax avoidance can form part of the battery of corporate risks investors should monitor and question when necessary;

3. corporation tax can be seen as a 'levy on the profit a company earns for its shareholders[1]' and should therefore be properly viewed as, at least in part, a tax on shareholders;

4. from a broader societal perspective, the tax base of a country is fundamental to the individual country's ability to provide infrastructure, legal protections and social services that help to build and develop an economy and support its citizens. This, in turn, improves markets and provides further opportunities to individual companies.

Investors often find it difficult, if not impossible, to have clarity as to how a company's tax policies operate, particularly with regard to the complexities of transfer pricing between a company's operations in differing legal jurisdictions. In some cases, management may have a legitimate desire to keep such strategies private for competitive reasons. This should not mean, however, that investors should be unaware of how tax strategy is defined, monitored and governed. There are sound reasons to argue for more disclosure in some areas so investors may be allowed to decide for themselves if the risks relating to tax policy outweigh other attractions of the investment. If investors understand a company's tax policy and strategy but disagree with it, they may wish to take this into account in their company engagement and investment decisions.

The ICGN believes that companies, regulators and governments alike should take into account legitimate investor views as the tax debate continues. In turn, investors should strive to better understand tax policies of their investee companies and, where appropriate, seek to communicate their views on tax risk appetite to management and boards.

**Company dialogue**

The ICGN encourages companies to enhance disclosure by boards or audit or risk committees on how they oversee management activity with respect to tax strategies. Boards should seek to provide proper tone and oversight to ensure that company's tax policies are both prudent and sustainable.

Further, the board and relevant committees should ensure that, within their ranks, they have adequate knowledge of the implications of tax strategies on the long term value and profitability of the company, and seek any external expertise they may need to fully understand the approach taken by management. For example, a specific yardstick for investors would be to monitor key strategic decisions or transactions which are done purely for tax reasons with little

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[1] *An argument advanced by, among others, John Kay,in 'Don't blame the havens – tax dodging is everyone else's fault'; Financial Times, May 2013*

or no real relationship to the company's operations; this is likely to indicate aggressive risk and therefore heightened reputational risk

Some questions for consideration when entering into dialogue with companies on the subject of corporate tax policies are as follows:

1. What is the nature of the board's oversight of company tax policy? Is this discussed at the overall board meetings or in specific committees?

2. Does the board discuss company tax policies directly with the accounting firm providing tax services?

3. Does the board recognise that tax policy that may be perceived as overly aggressive may carry reputational risks? If so, does the board think in terms of a "risk appetite" for reputational risks that may related to tax policy?

4. How does the board satisfy itself that a company's approach to tax may be appropriate or inappropriate?

5. Does the company have an articulated policy on its approach to corporate tax? Is this policy public and do company disclosures provide evidence as to how this policy is overseen and controlled?

**About ICGN Viewpoints**

ICGN Viewpoints provide opinion on emerging corporate governance issues and are intended to generate debate, whilst not defining a formal ICGN position on the subject. ICGN Viewpoints are produced by our member-led Policy Committees and we encourage dialogue by contacting Committee chairman directly or the ICGN Secretariat as follows:

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