Analysis

Tax and corporate governance: joining the dots

Speed read

From 2019, large private companies will be required to explain their approach to corporate governance in their annual directors' report. Listed companies already have similar requirements under the Cadbury Code. Tax is increasingly seen as a corporate governance matter, with HMRC acting as a quasi-regulator. Groups, whether private or listed, need to develop a coherent approach to manage the numerous tax governance-related measures. A corporate governance code, like the new Wates Principles, can help provide a meaningful framework for dealing with tax risk.

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Corporate governance: 2019 reforms

What is your group's approach to corporate governance? For listed companies, this is not a new question: the company's annual report must include a statement about compliance with the Corporate Governance Code (often referred to as the Cadbury Code), or explain why there is non-compliance. A refreshed code was published in July 2018 and takes effect from 1 January 2019.

Private businesses, regardless of size, have never been challenged in this formal way on their governance arrangements. From 1 January 2019 that will change. The largest private companies (those with more than 2,000 employees, or with over £200m turnover and a £2bn plus balance sheet) will need to state in the annual directors' report which corporate governance code they have applied and how. Any departures from the code must be explained.

> HMRC is increasingly acting like a regulator, not just a tax collector

The natural choice for many groups will be to adopt the Wates Corporate Governance Principles for Large Private Companies (see box 1). These were published in December 2018 (see bit.ly/2UE31rx), following consultation by the FRC on behalf of a Coalition Group chaired by James Wates CBE (chairman of the Wates Group). The FRC paper provides that companies using the Wates principles will be expected to apply them fully, explaining how their processes work to achieve the desired outcome of each principle and how applying the principles has resulted in improved corporate governance.

Box 1: The Wates Corporate Governance Principles for Large Private Companies

- **Principle one: Purpose and leadership** – An effective board develops and promotes the purpose of a company, and ensures that its values, strategy and culture align with that purpose.
- **Principle two: Board composition** – Effective board composition requires an effective chair and a balance of skills, backgrounds, experience and knowledge, with individual directors having sufficient capacity to make a valuable contribution. The size of a board should be guided by the scale and complexity of the company.
- **Principle three: Board responsibilities** – The board and individual directors should have a clear understanding of their accountability and responsibilities. The board's policies and procedures should support effective decision-making and independent challenge.
- **Principle four: Opportunity and risk** – A board should promote the long-term sustainable success of the company by identifying opportunities to create and preserve value and establishing oversight for the identification and mitigation of risks.
- **Principle five: Remuneration** – A board should promote executive remuneration structures aligned to the long-term sustainable success of a company, taking into account pay and conditions elsewhere in the company.
- **Principle six: Stakeholder relationships and engagement** – Directors should foster effective shareholder relationships aligned to the company's purpose. The board is responsible for overseeing meaningful engagement with stakeholders, including the workforce, and having regard to their views when taking decisions.

Tax – a corporate governance matter

Neither the Cadbury Code nor the Wates principles say anything directly about tax. With 'tax governance' and 'tax risk' currently a focus for HMRC, we have been speaking to businesses (in particular, large private companies) about building an approach to tax matters within a wider framework for corporate governance.

Individuals with responsibility for tax matters at large businesses will be aware of the daunting array of tax-related governance matters for groups to manage. Box 2 summarises some of the recent legislative measures and HMRC initiatives. The challenge is to bring it all together with a meaningful framework. In this regard, it makes sense to take a holistic approach. In this article, we use the Wates principles to set out how that type of framework can help.

Don't be evil

Start with purpose (principle one). If a business can articulate its purpose, or its mission or values, then it already has a starting point. To take a famous example, Google has long been associated with the corporate motto 'don't be evil'. From that simple statement, a board can get a sense of its responsibilities (principle three) and the

Box 2: Recent tax governance-related measures

Measure	Description	Target	With effect from
Accelerated payment notice (APN)	An APN is issued by HMRC to taxpayers involved in avoidance schemes disclosed under DOTAS, counter-acted under the general anti-abuse rule (GAAR) or in relation to a follower notice (FN). They come with a requirement to pay the disputed amount of tax on account.	All taxpayers.	July 2014.
Business risk review	The business risk review is a core feature of how HMRC manages the tax compliance of the largest businesses. The review is a key determinant of the level of scrutiny and resource the business receives from HMRC. The process has undergone limited change since its introduction over ten years ago and is currently under review by HMRC.	Large businesses. Some 1,200 have been identified by HMRC with turnover > £200m or complex business model / sector.	March 2007.
Common reporting standard (CRS)	CRS is a standard for the automatic exchange of information by banks, insurers, and funds about their investors and customers on a global level, between tax authorities.	Banks, insurers, funds and other financial institutions.	May 2017.
Corporate criminal offence (CCO)	The CCO for failure to prevent the facilitation of tax evasion requires businesses to take reasonable procedures to prevent tax evasion and comes with a criminal liability for businesses that fail to put those procedures in place.	All businesses.	September 2017.
Country by country reporting (CBCR)	Large multinational businesses must report certain information annually to the tax authority for each tax jurisdiction in which they do business. Information includes global profit, assets and number of employees. The UK has enabling legislation to make the information public; however, this has not been switched on yet.	Large multinational businesses.	Accounting periods starting on or after September 2016.
Directive on administrative cooperation (DAC 6)	EU member states are required to implement legislation requiring the disclosure of details of cross-border arrangements where certain ‘hallmarks’ apply – similar to the UK’s DOTAS rules (see below) but goes further in some cases.	Advisers, unless legal privilege.	Transactions from June 2018 (reporting by August 2020).
Disclosure of tax avoidance schemes (DOTAS)	DOTAS is designed to enable HMRC to obtain early information about how certain tax arrangements work and who has used them.	Advisers, unless legal privilege.	August 2004.
Fair tax mark	The fair tax mark certification scheme seeks to encourage and recognise organisations that pay the right amount of corporation tax at the right time and in the right place.	All businesses but bias towards UK based businesses.	February 2014.
Follower notices (FNs)	Follower notices can be issued by HMRC where an enquiry or tax appeal is in progress in relation to ‘arrangements’ where it is reasonable to conclude that obtaining a ‘tax advantage’ was the main purpose or one of the main purposes of the arrangements.	All businesses but aimed at marketed avoidance schemes.	July 2014.
General anti-abuse rule (GAAR)	Anti-avoidance legislation that counteracts abusive arrangements. The first opinion from the panel was published July 2017. Penalties up to 60% of the counteracted tax have subsequently been introduced.	All taxpayers.	July 2013 with penalties for transactions entered into from September 2016.
Senior accounting officer (SAO)	The SAO must take reasonable steps to establish and maintain appropriate tax accounting arrangements. The SAO makes an annual declaration and is personally liable to penalties if reasonable steps not in place.	Large businesses defined as having an annual turnover > £200m; and/or balance sheet assets > £2bn.	Accounting period from July 2009.
UK tax strategy	Large businesses must publish (and update annually) their UK tax strategy setting out the organisation’s approach to risk management and governance of its UK tax; attitude towards tax planning; the level of risk willing to accept in relation to UK tax and its approach to its dealings with HMRC.	Large businesses defined as having: group revenues > €750m; UK turnover > £200m; or UK balance sheet assets > £2bn.	Publish before the end of the accounting period starting after September 2017.

expectations of stakeholders (principle six). This can then inform the entire approach to tax governance: the board has set itself a benchmark and can expect to be called out if a failure in any of the areas identified in our chart looks like it might be ‘evil’.

More than ever, the board needs to ensure the company’s purpose permeates through the business – including to the tax department. Many groups have published a UK tax strategy (on either a mandatory or voluntary basis), and the most meaningful strategies are those that reflect the wider values and culture of the organisation.

Tax in the boardroom

The next two principles (board composition and responsibilities) are much more important in relation to tax matters than was once the case. HMRC is increasingly acting like a regulator, not just a tax collector. Its challenge to groups (reduced to the core message) is: are you taking tax matters seriously enough?

Groups will need to show that there is somebody on the board who has enough knowledge of tax matters to provide effective oversight and to inform top level decision making. If the head of tax does not participate in board meetings, companies need the right processes in place to ensure they have the necessary information to make proper decisions about tax matters.

Some board members may have personal responsibility (and potential liability) for tax matters, such as the SAO. The company itself may face criminal liability (under the CCO) if it fails to discharge its responsibilities.

> Groups risk being caught out if they have not developed their approach to tax as a public policy matter

A succession of measures in relation to avoidance (DOTAS, the GAAR, APNs, FNs and so on) has put tax governance firmly on the boardroom agenda, with material reputational risks if the choices that a business makes in relation to tax are perceived to put the company on the wrong side of the line.

Similar points are relevant for principle four (opportunity and risk). The idea of 'tax risk' is a key focus for HMRC – and the assessment by HMRC of individual businesses is likely to become more sophisticated under the business risk review. Boards must be able to show that they understand the group's attitude to tax risk and have appropriate risk management procedures in place.

In the information age, directors also need to understand what data is being collected and shared with tax authorities (e.g. under CBCR, CRS and DAC6 – as box 2 explains) and to maintain appropriate controls. Boards may also be privy to information which can legitimately be withheld – such as privileged legal advice. A strategic approach is required to prevent loss of privilege or inadvertent disclosure.

Who are your stakeholders?

The final principle six (stakeholder relationships and engagement) is perhaps the most interesting from a tax point of view. Many companies now engage actively with customers and employees on tax matters, publishing their strategies on tax and explaining their total contribution in taxes paid in different jurisdictions.

The idea that HMRC, or the wider body of taxpayers, is a 'stakeholder' in the company might have sounded unusual a few years ago. Not now. The impact of pressure groups, and public interest in corporate tax matters, has pushed this up the agenda. For companies that want to be on the front foot in this area, typically domestic consumer facing businesses, initiatives such as the fair tax mark can reward positive engagement on tax with external stakeholders.

Groups risk being caught out if they have not developed their approach to tax as a public policy matter. This brings us back to the first principle: purpose. As the Wates principles put it, 'directors should foster effective stakeholder relationships aligned to the company's purpose'. Once a company can articulate its purpose, it should have the foundations for a coherent and practical approach to tax as a corporate governance matter. ■

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