Tell the whole tax story
It’s more than just numbers

PwC

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Highlights

**Tax tops political and regulatory agendas**

Tax and transparency have never been higher up the political agenda than in recent months. Along with trade, they are part of David Cameron’s economic priorities for the G8 under the UK presidency in 2013.

2012 saw the introduction in the US of legislation requiring companies in the extractive industries to publish details of tax payments on a country-by-country basis. Country-by-country rules are also likely to be introduced into EU legislation in the near future. The EU Parliament is considering new legislation to require country-by-country reporting for extractive and logging industries as well as banks.

The UK Public Accounts Committee has also focused on tax in recent months, questioning Google, Amazon and Starbucks on their tax affairs and also interviewing tax leaders of the big accounting firms on their role as tax advisors. The Energy and Climate Change Select Committee recently questioned energy companies on their tax payments.

On top of the political interest in tax and transparency, civil society organisations (CSOs) and the media have kept up the momentum of their investigations into the tax affairs of multi-national companies.

**Can your tax reporting withstand public scrutiny?**

In this climate, more people than ever before are looking at companies’ tax affairs and they are looking at them more closely and more sceptically and taking a view on whether companies are ‘doing the right thing’.

It is vital that if your tax reporting comes under the scrutiny of this wider stakeholder group that it can be easily understood and that it helps to build trust.

We think good tax reporting should consider the whole story around tax, going further than statutory reporting and being aware of what your stakeholders expect to be told. We are seeing more examples of commentators developing an expectation of how much tax businesses should pay and then comparing that to the company information. Gaps between the expectation and the reality can damage trust.

If you are able to address such expectation gaps and provide information on the wider impact of the tax you pay, it will help your stakeholders to understand the full story, inform the wider debate and help to ensure that expectations are appropriate in the first place.

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1 PwC Annual CEO survey
2 Statistics in this report are based on PwC’s BPTA review of 50 companies with the most disclosure on tax in the FTSE350
At a glance

Total Tax Framework – how to start telling the whole story

1. Tax strategy and risk management
   - Is there clarity over tax objectives and strategy?
   - Are there clear policies in key areas for the business, eg, tax planning and transfer pricing?
   - How are the tax strategy and function managed and who has responsibility for governance and oversight?
   - What are the material tax risks?

2. Tax numbers and performance
   - Is there a clear reconciliation from the tax charge to the statutory rate?
   - How do cash tax payments relate to the tax charge?
   - Can you share forward-looking measures for tax, eg the future direction of the company tax rate?

3. Total Tax Contribution and the wider impact of tax
   - How does tax impact on wider business strategy and results?
   - Have there been any advocacy and tax lobbying activities?
   - What is the impact of tax on shareholder value?
   - Can you communicate the economic contribution of all taxes paid?

Only 28% of the top 50 tax reporters clearly communicate their tax strategy and risk management

72% of the best tax reporters in the FTSE 350 still don’t report tax numbers and performance clearly

A third of companies reviewed reported effectively on their total tax contribution

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1. Tax transparency building public trust – PwC review of the 50 best tax reporters in the FTSE 350
A tax strategy builds trust, if you follow it

A well communicated tax strategy can allow you to say more about tax, more meaningfully, than just releasing increasingly detailed numbers. The more data there is, the more open it is to misinterpretation and the greater the risk that the important messages that you want to communicate are lost in a noise of numbers.

Knowing who is responsible for tax, what the attitude of a business is to tax risk and to tax planning can be useful for investors and other stakeholders. A good description of tax strategy can also show how tax is aligned to the underlying economics of a business and how the two complement each other. It can also show how the tax strategy aligns with wider corporate social responsibility aims.

Communicating your tax strategy can help to build trust with stakeholders as they can see what your approach to tax is and how it fits in with your wider business strategy and your brand values. But this trust can be undermined if a company’s actual activities do not appear to be fully aligned with its stated tax strategy.

Noise of numbers or clearly aligned tax strategy?

Companies should expect their tax strategy to be scrutinised by the media and CSOs. Recent campaigns have seen companies’ tax affairs being examined using not only group accounts, but also individual company statutory accounts, websites and even interviews with current and former employees.

This information can reveal areas where an organisation’s everyday operations may not appear to be in line with its communicated approach to tax and this can lead to questions about its trustworthiness.

For example, if a business’s stated tax strategy is not to use aggressive tax planning, and to avoid tax havens, it should be alert to any subsidiaries that it has in tax havens; and not just traditional tax havens such as Bermuda or the Cayman Islands, but also Luxembourg, Netherlands and Switzerland which are increasingly being viewed as tax havens by some commentators. If the use of these locations is not in line with the stated tax strategy and not explained, then this could lead to a breakdown in trust.

Explain developments or risk misunderstanding

Similarly, the successful resolution of a tax authority audit leading to increased tax payments could result in a tax strategy being questioned even if that strategy is based on non-aggressive tax positions and collaborative real-time relationships with tax authorities. The company needs to explain the position or risk others misunderstanding what has happened.

Our 2012 review of the tax reporting of the FTSE 350 shows that 62% of companies reviewed talk about governance and oversight of tax – less than half did this two years ago.

Clearly more companies are seeing the value of talking about their tax strategy, but with increasing scrutiny from stakeholders they need to be able to show how that strategy is applied in practice.

“Communicating your tax strategy can help to build trust with stakeholders as they can see what your approach to tax is and how it fits in with your wider business strategy and your brand values”
Tax is more than just corporation tax

Your Total Tax Contribution is a key element in explaining the full tax contribution that you make, over and above corporation tax. It is also important for informing stakeholders about the impact on the business of all the taxes that you pay and the relative size of those taxes.

Corporate income tax is still the tax that receives the bulk of the attention from politicians and the media – they have largely ignored the other taxes to date. While important, corporate income tax is only a small part of the government’s total tax receipts. Sharing your Total Tax Contribution can help to show that your business makes a significant additional contribution to government through sales taxes, employment taxes and other business taxes. It highlights that businesses still pay tax even where corporate income tax payments are low perhaps due to poor results, the use of prior year losses, capital investment or the application of tax incentives for investment or research.

“Total Tax Contribution is designed to be easily understood by everyone, not just by tax specialists”

Explain what you pay and collect

Total Tax Contribution splits taxes into taxes borne and taxes collected. Taxes borne are those taxes that are a cost to the business and have an impact on profits after tax. These include employers’ social security payments, irrecoverable VAT, business rates as well as corporate income taxes.

Taxes collected include taxes that a company generates, collects and pays to government on behalf of other people. They include income tax and social security contributions withheld from employees and VAT and other taxes levied on the sale of the company’s goods and services. While taxes collected are not a direct cost to the company, they are part of the value that the business creates for the economy and for which the business acts as an unpaid tax collector for government.

A clear distinction between taxes borne and tax collected is vital as companies do not bear the cost of taxes collected, even though they collect them and pay them to government.

Total Tax Contribution is designed to be easily understood by everyone, not just by tax specialists. To do this it looks only at tax actually paid within the reporting period, ignoring deferred tax and other adjustments made for accounting purposes.

More companies are choosing to report their Total Tax Contribution in their financial accounts and their corporate social responsibility reports. Last year 34% of companies in our review mentioned tax other than corporate income tax in their reporting, compared to only 22% in the previous year².

Different taxes companies pay by percentage

The chart shows the taxes borne by companies that are a cost to the business and directly affect financial results.

Source: Surveying the Hundred Group – PwC 2012 survey of the Hundred Group of Finance Directors
How much tax do you pay in each country?

This question is unlikely to go away. Disclosing the total tax paid in every country where you operate can be a good way to show the contribution you make to economies all over the world, although the potential cost of doing so needs to be considered. For the extractive industry in particular, the payments made to governments are seen as a significant part of their licence to operate.

The idea of reporting the amount of tax paid in each country where a business operates was first introduced in the early 2000s. The Extractive Industries Transparency Initiative, announced in 2002, requires companies operating in participating countries to disclose their payments to governments in those countries. These are then independently reconciled against government receipts.

Since then other country-by-country initiatives have been promoted and the first law requiring country-by-country reporting was passed in the US in 2012 as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act).

The Dodd-Frank Act requires extractive companies registered with the US Securities and Exchange Commission to publish the amount of tax paid in each country on a project-by-project basis.

Regulators and CSOs fuel the trend

The EU is considering a similar law as part of amendments to its Accounting and Transparency Directives. These amendments were originally drafted to include the extractive and logging industries, but extending these rules to other industries is a serious possibility. The Capital Requirement Directive and Regulation also contains further proposals for country-by-country reporting for banks, including not only details of taxes paid, but of profits, revenues and staff numbers by country.

Some CSOs would like this kind of information from all companies. The Tax Justice Network in particular is calling for all these disclosures as well as fixed assets by country and a split between related and third-party transactions.

The CSOs want this information so that they can draw conclusions on whether the “right amount” of tax is being paid. In the absence of this data, they have been taking a simplistic approach to estimating the amount that they think should be paid.

What’s ‘the right’ amount of tax?

Typically, CSOs start with the assumption that a group’s profit margin should be the same in all countries. This global margin is then applied to the sales in a particular country to arrive at the profit attributable to that country. Applying the local statutory tax rate then gives an approximation of the tax that the CSOs expect to be paid in that country. If the actual amount of tax is significantly lower, then CSOs may ask why.

Although disclosing tax payments on a country-by-country basis was only mandatory in 2012 for extractive companies in EITI countries, 25% of companies that we reviewed did disclose some tax payments on a country-by-country basis.

“This question is unlikely to go away”
More questions about tax – but what about the answers?

Recent media and political pronouncements highlight the importance of tax to a wide range of stakeholders – not only those that have traditionally been interested in tax, such as shareholders and tax authorities, but also employees, consumers and wider civil society.

We have also seen financial analysts looking at effective tax rates when considering investment decisions. We have seen examples where analysts take the approach of estimating a statutory weighted effective tax rate based on the geographical split of revenues and the tax rates in those countries. If the actual effective tax rate is considerably lower than this estimated rate, then the analyst recommends that investors ask questions to see if the low rate is the result of an aggressive tax policy to minimise payments.

Companies that have an actual effective tax rate that is substantially below their statutory weighted tax rate should think about explaining this difference. In our review we identified only a handful of companies that reconciled a statutory weighted tax rate to the actual effective tax rate.

What’s the impact of tax on your business?

Most companies carried out their tax reconciliation using the statutory rate of the parent company, but this may not be the best rate to use where the majority of revenue is generated outside the parent company’s tax jurisdiction.

As well as looking at effective tax rates, readers of accounts might question the impact on tax of the following:

- The location of assets, both tangible and intangible that are in countries other than those where sales are made
- The location of asset ownership if it is different from the location of their operation or use
- The use of captive finance and insurance companies
- The flow of funds between related companies, particularly where these involve tax havens or funds that are not remitted back to the parent company

Are people drawing the right conclusions?

If someone was to question the impact of tax on your company’s strategic decisions, what conclusions could they draw from your reporting and other publicly available information? Would their conclusions be the right ones?

33% of companies mention the importance of tax transparency or stakeholder interest in their tax payments.

“Companies that have an actual effective tax rate that is substantially below their statutory weighted tax rate should think about explaining this difference”
# Topics for 2013

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- **January**: *Tell the whole tax story – It’s more than just numbers* Building public trust
- **February**: Have a backbone
- **March**: *The big picture*

- **April**: *Tell the whole tax story*
- **May**: Back to basics
- **June**: Survival of the fittest

- **July**: *Cash is still king*
- **August**: Flash in the pan
- **September**: Not the kitchen sink

- **October**: *Cracking the code*
- **November**: Joining the dots
- **December**: *Joining the dots*
How can PwC help you?

If you'd like to discuss your tax strategy and reporting, please speak to your usual PwC contact, or one of the people listed here.

PwC has a strong network of people who can advise on all aspects of tax and how to report it clearly to stakeholders.

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