



ZEN and the Art of Tax Compliance

The five streams of consciousness and the Quest for
Certainty and Voluntary Compliance

ATO Large Business and International Presentation
29 July 2009 – Grace Hotel, 77 York Street, Sydney

Agenda

- The Five Streams of Consciousness.
- The Timeline of Tax Uncertainty.
- The Quest for Certainty in "Real Time".
- The Origins of Tax Uncertainty and the need for a Remedy.
- The Quest for Voluntary Compliance.
- Zen - Driving Tax Performance - the Path to Enlightenment.
- Conclusion.
- Questions.

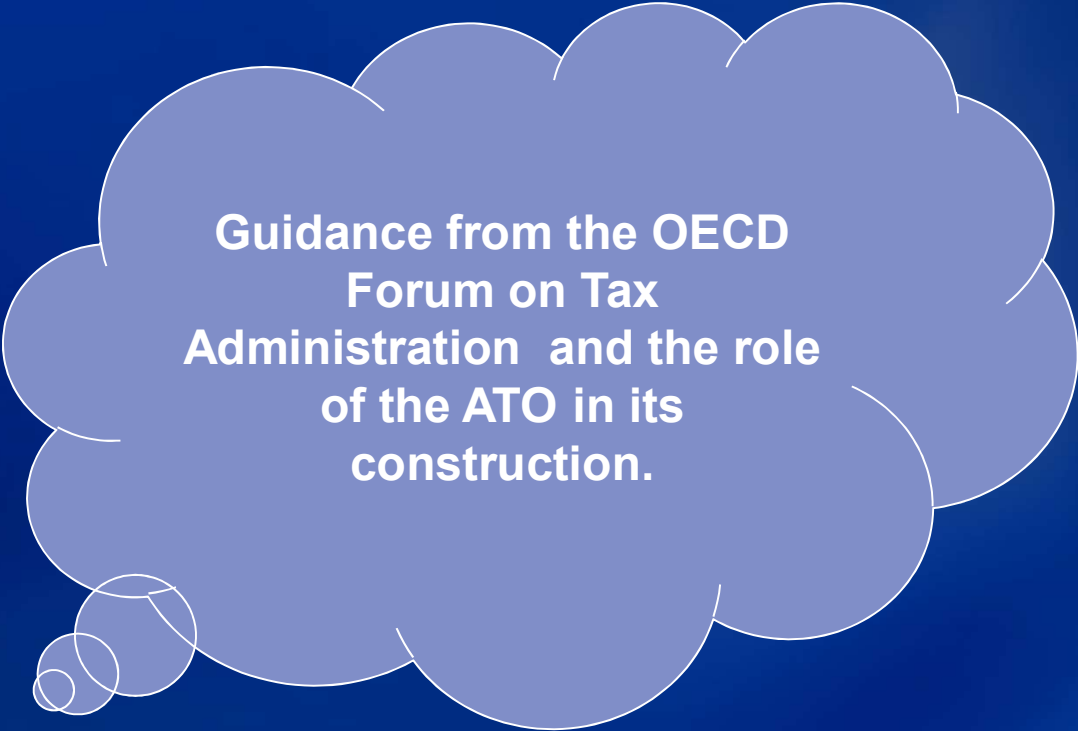
The Five Streams of Consciousness

1st Stream of Consciousness




**The ATO Risk based
approach to achieving
Voluntary Compliance in a
self-assessment
environment.**

2nd Stream of Consciousness



**Guidance from the OECD
Forum on Tax
Administration and the role
of the ATO in its
construction.**

3rd Stream of Consciousness



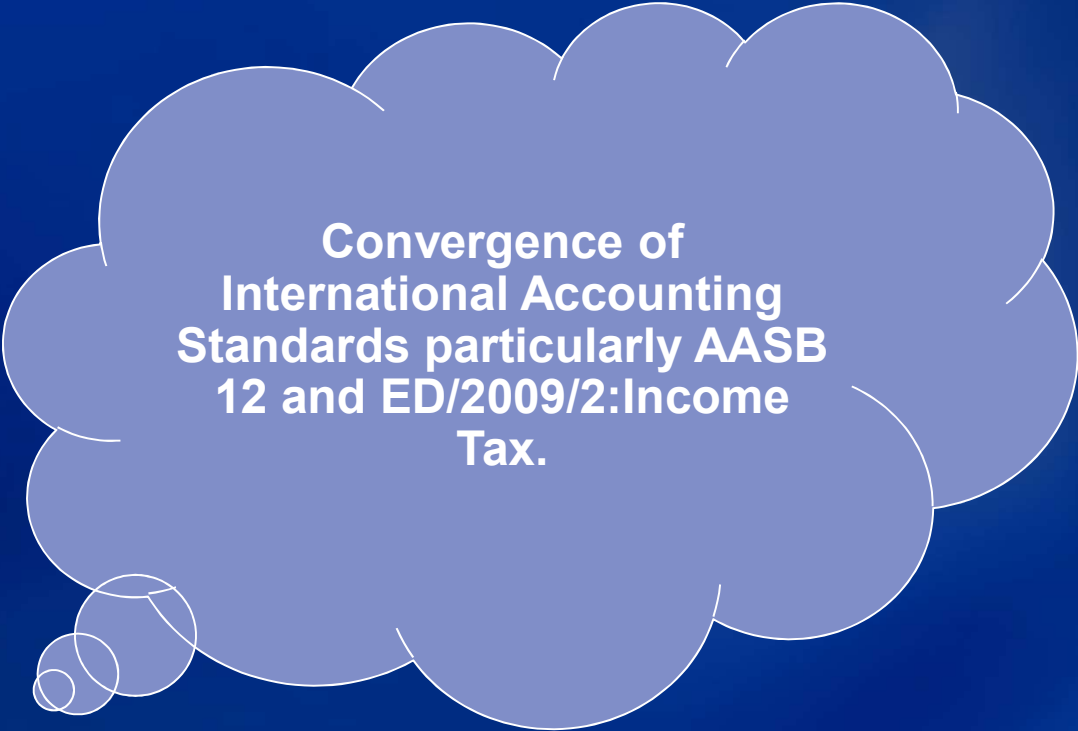
**Trends in Corporate
Governance and Regulation
in the wake of the GFC and
corporate collapses and
Revenue Authority
approaches.**

4th Stream of Consciousness



**Integration of Tax
Uncertainty (Tax Risk) in
International COSO and
ASNZ Enterprise Risk
Management frameworks.**

5th Stream of Consciousness



**Convergence of
International Accounting
Standards particularly AASB
12 and ED/2009/2:Income
Tax.**

1st Stream of Consciousness

ATO Risk Based Approach to Voluntary Compliance

- **Evolution to 2008/09.**
- **Increasing Active Compliance with additional funding.**
- **Dramatic decline in forecast Tax collections.**
- **The 2009/10 ATO Compliance Program.**
- **Increasing information gathering and risk profiling capability.**
- **Risk : Consequence Quadrant Analysis.**
- **Key Projects – ACA, Book to Tax, SME - \$100-250M.**

2nd Stream of Consciousness

Guidance from the OECD Forum on Tax Administration and the role of the ATO in its construction

- **The role of self-assessment since 1986.**
- **ATO contribution to OECD Guidance on Transfer Pricing.**
- **ATO contribution on HNWI culminating in the Study release in May 2009 in Paris.**
- **OECD Committee of Fiscal Affairs – Risk Management Practice Note July 1997.**
- **Strategic Management Forum of OECD Committee of Fiscal Affairs – compliance risk management.**
- **London May 2002 – Forum on Tax Compliance Administration.**
- **ATO launches Annual Compliance Program 2002 – 2003.**

2nd Stream of Consciousness cont.

Guidance from the OECD Forum on Tax Administration and the role of the ATO in its construction

- **Guidance note “Compliance Risk Management: Managing and Improving Tax Compliance” October 2004.**
- **Forum on Tax Administration – June 2005 – Dublin Ireland.**
- **Mark Everson Commissioner of Inland Revenue before US Senate Committee on Finance – growing book to tax gap and role of advisers.**
- **The Seoul Declaration September 2006.**
- **The Study into the Role of Tax Intermediaries January 2008 – a definition of “aggressive tax planning”.**

2nd Stream of Consciousness cont.

Guidance from the OECD Forum on Tax Administration and the role of the ATO in its construction

- **The Paris Communiqué', May 2009.**
- **Release of the Study into Building Transparent Tax Compliance by Banks, May 2009.**
- **Paper on Corporate Governance and Tax Risk Management, May 2009 presented by Australia , Canada and Chile.**
- **Loughlin Hickey, KPMG Global Head of Tax contributed on behalf Of Corporates and Intermediaries and presented at the Paris Meeting of the FTA.**

3rd Stream of Consciousness

Overall Corporate Governance

Trends in Corporate Governance and Regulation in the wake of the GFC, Corporate and bank failures:

- **SOX 404;**
- **CLERP 9;**
- **ASX Principles 4 and 7;**
- **Section 296 (1) Corporations law;**
- **Increasing linkage to Tax.**

3rd Stream of Consciousness cont. Overall Corporate Governance

Linkage to Tax

- **Tax Control Framework for Large Corporates, Netherlands May 2008.**
- **Schedule 46 of the Finance Bill 2009 (UK) - Senior Accounting Officer sign-off – establish, maintain and monitor adequacy of accounting systems to producing accurate tax returns.**
- **Circular 90, State Administration of Tax, Peoples Republic Of China: Large Enterprises (45) plus others.**
- **Foreign Bank Risk Reviews.**

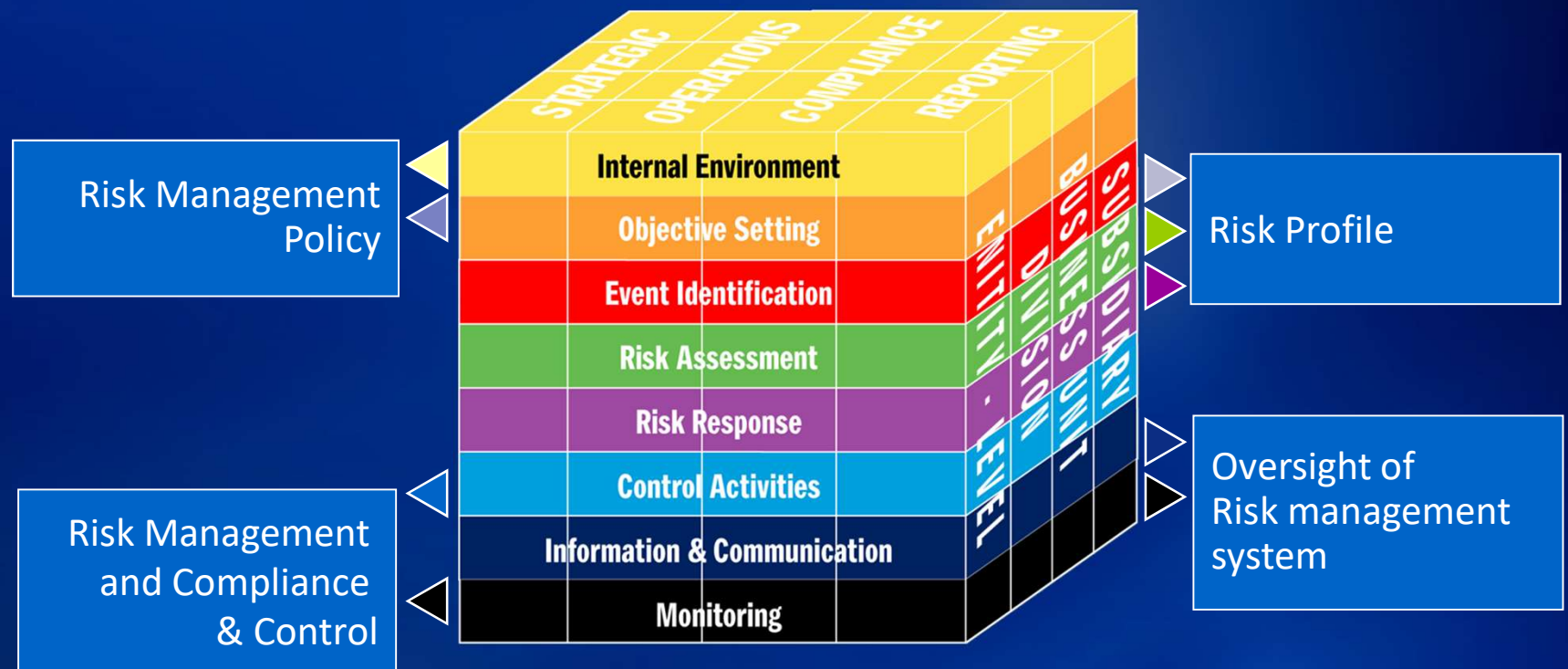
3rd Stream of Consciousness cont. Overall Corporate Governance

- **OECD Draft Paper on Corporate Governance and Tax Risk Management echoing the ATO approach since 2004, May 2009:**
 - A sound framework in place to manage its tax risks and comply with its tax obligations;
 - A well resourced in-house tax governance capability;
 - Reporting requirements to ensure that significant tax risks are elevated to the board level;
 - Appropriate review and sign off procedures for material transactions;
 - An effective tax risk mitigation capability including the company's relationship with the applicable tax jurisdictions; and
 - A capacity to regularly assess the effectiveness of tax governance systems.

4th Stream of Consciousness

Integration of Tax Uncertainties (Tax Risk) in COSO Risk Management Framework

Enterprise Risk Management Framework of the Committee of Sponsoring Organisations of the Treadway Commission (COSO). This can be applied to develop a structured approach to Tax Risk Management



4th Stream of Consciousness cont.

Risk Assessment process adapted from ASNZ 4360:2004

The following diagram outlines at a high-level the key steps in the risk management process. Information for each step would be gathered during the risk assessment facilitation exercise.

Identification

Identify business risks across the company.
Business risk is the threat that an event or action will adversely affect XYZ from achieving its objectives.
Consider both the upside (risk as in missing an opportunity) and downside (risk as a hazard).

Measurement

Assess each risk on the consequences and likelihood that they occur.
Consequence is the impact if the risk actually happened. It is viewed from a financial, safety, regulatory and reputation perspective.
Likelihood is the chance that the risk will happen or how often you might expect it to happen.
The combination of consequence and likelihood gives you a **risk rating**.

Risk
Management
Process

Monitoring

The level of monitoring controls will depend on the combination of the risk and the strength of mitigating controls.

Action steps

Ownership of the risk is assigned and action steps are identified to mitigate the risk to an acceptable level. There are a number of options available to reduce the risk including improving controls or insuring against the risk.

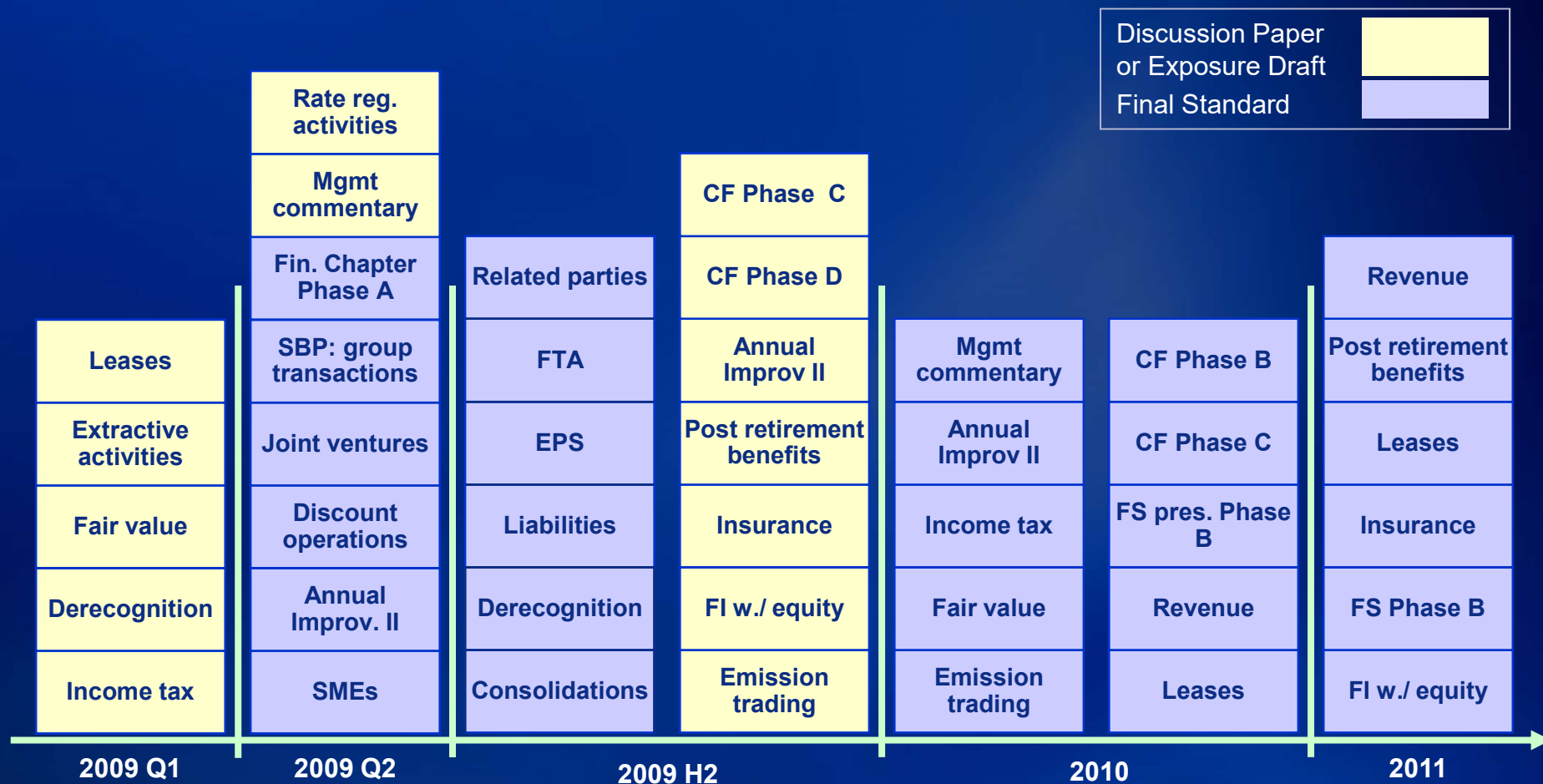
Control

For each risk, the business controls are considered to understand their effectiveness in managing the risk.

5th Stream of Consciousness

Accounting Standards

IASB work program



5th Stream of Consciousness cont.

ED 2009/2 – The snap shot

Scope	Unchanged
Balance sheet approach	Unchanged
Definitions	Revised
Exemptions	Revised
Uncertain tax positions	New
DTAs - recognition	?
- adjustment (P&L v equity)	Changed
Disclosures	Revised

5th Stream of Consciousness cont. ED/ 2009/2 - timetable



- **Proposed transition requirements:**
 - No restatement of comparatives;
 - Adjust opening balance sheet in year of application.

5th Stream of Consciousness cont.

ED/2009/2 Income Tax- Overview

- Tax Basis.
- Definitions of Tax credits and investment tax credits.
- Exemptions – initial recognition, investments in subsidiaries and associates.
- Uncertain Tax Positions.
- Recognition and Presentation of DTAs.
- Classification.
- Disclosures.

5th Stream of Consciousness cont. Uncertain tax positions- measurement

Proposal

- Measurement based on the **probability-weighted average** amounts of possible outcomes
- Classification of interest and penalties is an accounting policy choice

Current IAS 12

- No explicit guidance

NOT the US GAAP approach (FIN-48)

5th Stream of Consciousness cont.

Uncertain tax positions - Implications

- Position 60% certain entitled to \$10m deduction (gross)
(40% likelihood nil deduction)
- Tax return claims \$10m deduction (gross)

Today

- Deduction probable
- Nothing additional booked
- No disclosure

Proposal

- Expected deduction based on weighted average probability
\$1.8m ($60\% \times 10m + 40\% \times 0$ @ 30%)
- So need extra current tax payable of \$1.2m ($10m$ @ 30% less \$1.8m = \$1.2m)
- Specific disclosures

5th Stream of Consciousness cont.

Uncertain tax positions – example journal entries

From above example:

1. Record amount of deduction taken on tax return

Dr Income tax payable	\$3m	
		Cr Income tax expense
		\$3m

2. Reduce benefit taken by uncertainty

Dr Income tax expense	\$1.2m	
		Cr Income tax payable
		\$1.2m

3. On settlement of current year tax provision with ATO

Dr Cash	\$3m	
		Cr Income tax payable
		\$3m

Until final outcome known after statute of limitations expires leaves a provision of net \$1.2m in income tax payable to cover 40% uncertainty level

5th Stream of Consciousness cont. Uncertain tax positions

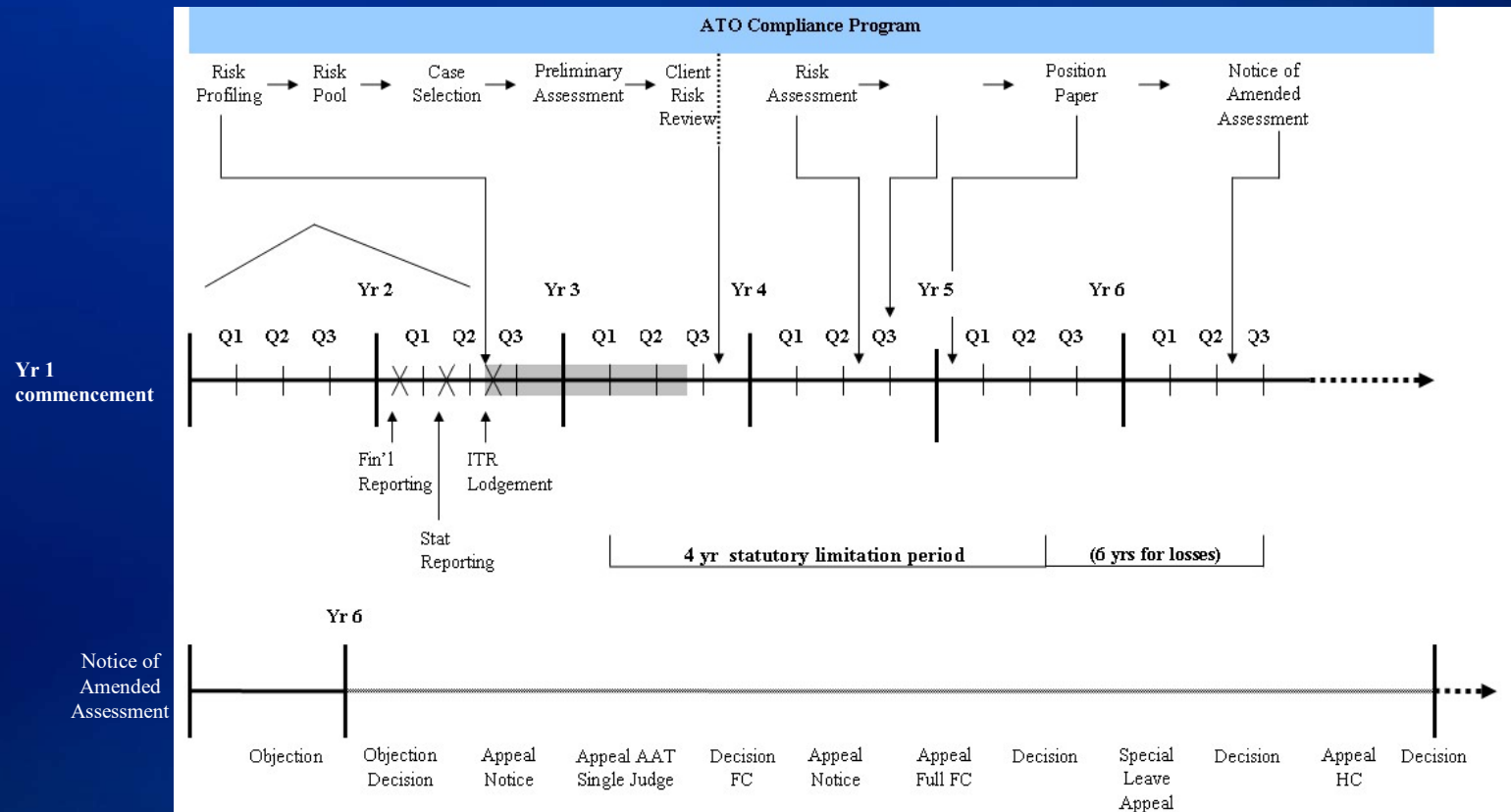


Access?



Revised
Guidelines?

The Timeline of Tax Uncertainty



The Quest for Certainty in "Real Time"

Certainty

- Large Business Advisory Group ("LBAG")
- Top 100 Meetings Program
- Rulings Program
 - Private (300 p.a.)
 - Class (90 p.a.)
 - Product (20 p.a.)
- Advance Pricing Arrangement ("APA")
- Forward Compliance Arrangement ("FCA")
- GST Annual Compliance Arrangement

Corporate Governance and Certainty

Certainty (cont.)

- **Annual Compliance Arrangements (ACA)**
 - Launched May 2008 – initial focus is top 50 businesses
 - Business provides assurances that tax risk governance requirements met
 - Annual joint risk assessment and management plan prepared
 - Objective – real time ATO sign-off

The Origins of Tax Uncertainty and the need for a Remedy

The role of the ATO..

“The Commissioner shall have the general administration of this Act.”

Section 8 ITAA 1936

“But remember that the ATO’s primary function is to administer the laws made by Parliament and that we are not a policy or law maker.”

Michael D’Ascenzo Commissioner of Taxation
23 January 2008

The Origins of Tax Uncertainty and the need for a Remedy cont.

- Literal vs. Purposive interpretation of the law
- Running with the Hares and Hunting with the Hounds – the essence of tax uncertainty.
- The identification of Parliamentary intent.
- These issues confront Voluntarily Compliant Taxpayers.

The Origins of Tax Uncertainty and the need for a Remedy cont.

- **Illustration in Recent Cases**

- You can't tax that ! The meaning of "the Australian income tax" and "Business Profits" in pre-CGT Double Tax Agreements
- The "same" business; "at all times" What did Harold Holt really mean ??? Does it matter 40+ years on?
- "**at** the leaving time" or "**Just before** the leaving time"??
- "What sort of entity are you?"

- **Division 13 and Division 974 – Interest free at call loans**
- **Capitalised labour and other changes of ATO interpretation**
- **There must be a better way !**

The Quest for Voluntary Compliance

Evolution of Risk Based Approach to Tax Compliance Administration

- **The Tax Compliance Model**
 - Understand factors influencing Taxpayer's compliance behaviour
- **Tax Compliance Pyramid**
 - Attitudes to Compliance
 - Escalating range of sanctions
 - Strategy to encourage voluntary compliance
 - Presented to the OECD Forum on Tax Administration Dublin Ireland June 2005

The Quest for Voluntary Compliance cont.

Tax Compliance Model

Factors influencing taxpayer behaviour



Attitude to compliance

Have decided not to comply

Don't want to comply, but will if we pay attention

Try to but don't always succeed

Willing to do the right thing

Compliance strategy

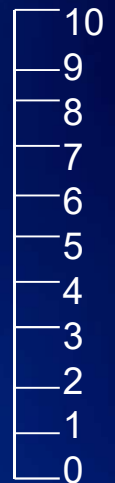
Use of the full force of the law

Deter by detection

Assist to comply

Make it easy

Our strategies aim to create pressure down



Zen - Driving Tax Performance – The Path to Enlightenment

From compliance
(SOX 404)

Driving Tax
Performance?



History

- Sarbanes-Oxley
- OECD Seoul Declaration/JITSIC
- FTA/Leeds Castle Group
- OECD Cape Town Communique
- The missing “supplier”
- G20/Tax Havens
- Pravin Gordhan – From Tax Commissioner to Minister of finance
- OECD Paris Communique

“We will continue to engage with business and with agencies responsible for the development of corporate governance codes and guidelines with a view to ensuring tax compliance is included as an aspect of good governance”
Paris May 2009

Evolution of Tax Authorities

- Strengthened transfer pricing
- Large Business Service
- Risk Assessment/Risk Transfer
- Board Engagement
- Corporate Governance

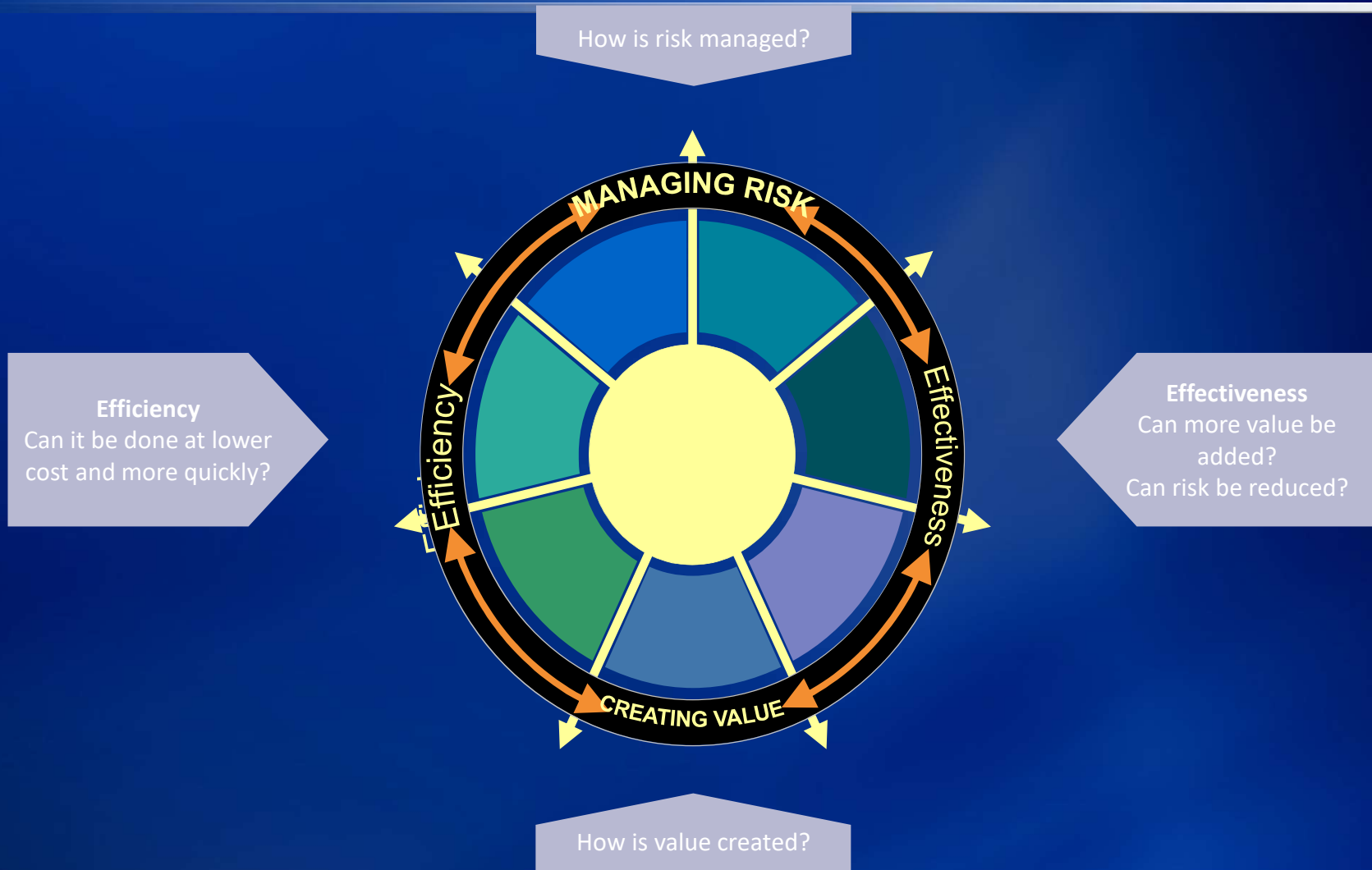
Emerging Consequences

- Greater transparency (FIN 48, XBRL)
- Tackling a mobile tax base

Recent Example outcomes

- Forward Compliance Agreements (Australia)
- Tax Control Framework (Netherlands)
- Circular 90 (China)
- SAO (UK)

Zen - Driving Tax Performance - the Path to Enlightenment cont.



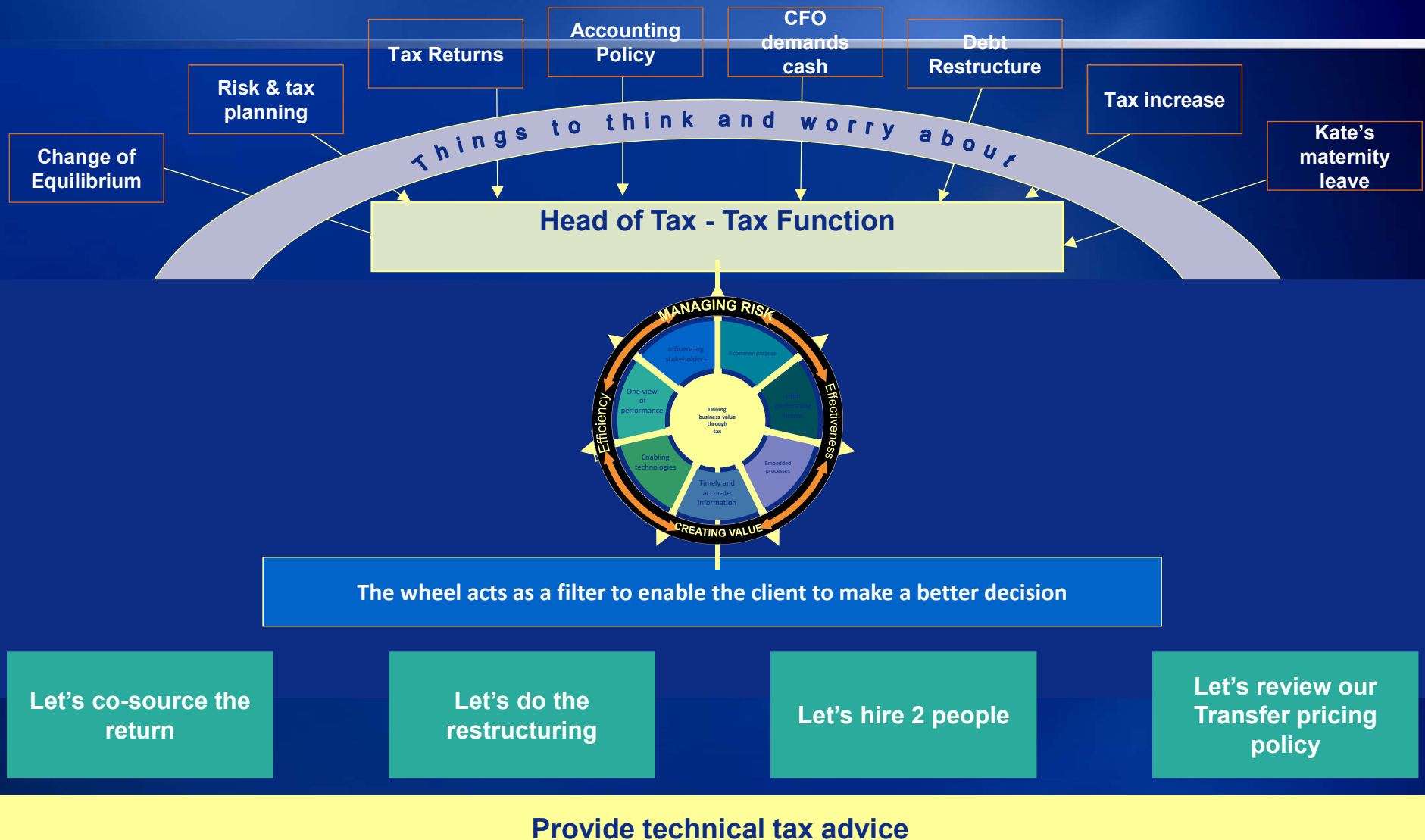
Zen - Driving Tax Performance – The Path to Enlightenment cont.



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Zen - Driving Tax Performance – The Path to Enlightenment cont.



The "Driving tax performance" compass articulates the critical success factors that should be integral to a leading tax function. In particular it depicts the balance that should be struck between the tax function managing its key risks whilst delivering its business imperative of creating value. The compass segments emphasise the business reach of tax and the importance of the relationship between tax, finance and the business. As well as balancing the 'creating value' and 'managing risk' equation the compass also helps you to understand the need to balance effective operation (driving performance improvement) with efficiency (driving down cost and speeding up delivery).

- Having a planned approach to key business relationship building, recognising the needs and constraints of the tax function staff and planning continuous improvement
- Creating an everyday, enterprise-wide recognised communication plan which recognises the tax function's key internal and external stakeholders, their needs and how these needs are addressed

- Create and maintain an agreed enterprise wide information system and performance framework enabling the organisation to assess and monitor the effectiveness and efficiency of the 'end to end' tax processes in line with the rest of the business
- Identify both the direct and indirect information that enables the organisation to manage, identify and mitigate risks and add value

- Tax sensitizing enterprise IT systems and effectively linking them to tax management software to create an end-to-end tax information system that supports automation and a clear audit trail.

- Clarity over the tax information needed will enable confidence that the needs of Tax and the business are being met. Without this information being available it is less likely that Tax will be able to meet the KPIs for its stakeholders; both internal (the CFO and the Board) and external (the tax authorities and shareholders)
- The need for timely and accurate information does not solely originate from within the Tax function; without clear communication between the Board and Tax (setting realistic objectives for Tax, strategic KPIs etc) Tax is unable to produce its own delivery programmes



- Clarity over what the business is trying to achieve
- Clarity over the fit between corporate and tax strategy and the key principles by which tax should be managed
- Clarity over what the tax function's strategic options are and a clear path to achieve the determined approach
- Clarity over the reach of the tax; which taxes does the business pay, record and account for and which taxes are the tax function accountable for
- Clear tax function objectives and communication policies in place which are understood both across the business and within the tax function

- Ensuring that the people in the Tax function (and those with tax responsibilities outside the tax function or a material interface or input into tax) recognise their role and responsibility and have the required technical and managerial skills to deliver their responsibilities
- Managing the training and development needs of the tax team and ensuring the team has a detailed career and development structure and is properly rewarded

- A common methodology and approach to tax process management across the organisation with clarity over accountability and responsibility between Tax and the Business
- Standardise, harmonise and automate the processes and controls across the organisation to manage tax risk to give confidence in the underlying tax numbers
- Introduce a common testing, monitoring and validation approach utilising the '3 lines of defence' model to ensure effective management, continuous improvement and independent verification of the key tax processes both within and outside the tax function

Conclusion

1. **Need for a Holistic approach by Revenue Authorities, Corporates and Intermediaries.**
2. **The need for a tri-partite enhanced relationship to address Tax Uncertainty and a new remedy to settle Parliamentary intent.**
3. **The impact of ED/ 2009/2 and post – GFC corporate governance and regulation should drive tax into ERM frameworks and upward to the Boardroom. The OECD Guideline on Corporate Governance and Tax Risk Management is timely.**
4. **The Exercise of Access Powers in relation to Corporate Governance of Tax, Tax Risk Management and Accounting for Tax Uncertainty documentation will be of increasing significance.**
5. **The observed downward pressure on Heads of Tax in Corporate Org charts is counter-intuitive.**
6. **There is a need to build mutual trust to deliver to those taxpayers who are recognisably Voluntary Compliant.**
7. **Voluntary compliance must cost less.**



QUESTIONS?

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