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# Corporate Tax Conference

## Tax & Ethics


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# 1 Introduction

The dusty old world of tax finds itself in the midst of a revolution. Once upon a time the tax function could happily sit quietly in the back office of an organisation gathering and crunching numbers away from the humdrum of day-to-day business, the excitement of the decision making Board or the eager scrutiny of the media and public. Armed with his trusty tax legislation, the tax advisor of yesterday was free to go about his business, be it simple compliance or cleverly constructed legal tax avoidance structures, in fear only of the occasional check-up and scrutiny by the tax office, and in some rare cases, the courts. Paying more than one's fair share of tax back in those days was pure folly, and indeed minimising the tax liability as far as possible the ethical objective of a tax advisor to his business:

> ***"No man in the country is under the smallest obligation, moral or other, so to arrange his legal relations to his business or property as to enable the Inland Revenue to put the largest possible shovel in his stores" – Lord Clyde, 1929***

This gave rise to the familiar metaphor of the 'black box' of tax with only those skilled in the mysteries of tax law and accounting afforded access and understanding.

What we now know, is that those days are gone. Instead, tax professionals now find themselves in a place they are highly unaccustomed to being: the limelight. Under the metaphor of the black box of tax, the lid is being lifted and there is increasing cross-examination of the workings within the black box, with the harsh light of scrutiny begging questions of morality and ethics. The tax professional is having their work examined by reference to concepts beyond reasonable prospects of legal maintainability on review by a tax authority.

Be it at the Board, in the business, in the media or on Twitter, recent events in the world have conspired to bring tax to the forefront of the public eye. As governments scramble to plug the national debt they accumulated in the good days pre-GFC, and public services are cut against the backdrop of falling revenues, a disillusioned public is now looking to where the government funding comes from and the need for a greater contribution from business when profits are falling. Those perceived as shirking or avoiding their responsibilities to contribute to consolidated revenue now stand to be condemned. Tax risk, once seen as predominantly a financial risk, is now assessed equally by reference to reputational risk. Tax outcomes are scrutinised by reference to exercise of good corporate governance and citizenship and the unwritten terms of a 'license to operate', particularly in developing countries. The moral code for tax has changed, and the ethical guidelines are struggling to keep up. This shift in perspective has the global community's support and the debate is quickly moving from the legal black and white of right and wrong to the technicolour of morality, ethics and 'doing the right thing'.

As business has globalised and the traditional jurisdictional boundaries and pre-digital concepts of source, residency and permanent establishment are tested the world looks increasingly to the economic outcomes of a global business and how most appropriately to share it. Yet the jurisdictions continue to compete for investment through use of their tax systems, condemning them to be found to speak with forked tongue.

But how do we define and work to something as fluid as morality in the tax environment? How do we deal with the risk of being perceived as not paying our fair share when opinions on the subject will always abound? Is this really the heralding in of a new era for the tax world?

# 2 What is the difference between ethics and morals?

While often confused as one and the same, there is a fundamental difference between ethics and morals. Morals are an individual's particular belief in ideals and principles, right and wrong. Morals govern an individual's own conduct and will differ from person to person.

Ethics are rules or standards governing the conduct of a person or a member of a profession which are adopted by a particular group of people. Ethics are often codified (such as the *Tax Agent Services Act 2009 (Cth)* Code of Conduct (Code) the Taxpayers' Charter or the ASX Corporate Governance Principles and Recommendations with 2010 amendments.

The moral and ethical codes of conduct, under which tax professionals provide services may not always align. Overlay this with the ethical codes under which your client operates, those with which the Australian Taxation Office (ATO) complies, any additional industry code; marry these with your own individual moral beliefs and it is unsurprising to find that there are differences in expectations. What the community expects of companies (payment of their 'fair share' of tax) and what companies expect their tax advisors to do (pay the legally required amount of tax) are not necessarily the same thing.

What has recently come to the fore is that the global community has a higher expectation of what constitutes ethical taxpayer behaviour than that which has been codified. That is, it is no longer enough to simply comply with the law. Corporate social responsibility now includes, 'fair and reasonable' payment of tax in compliance with the purpose and rationale of the law, beyond what is 'due and payable' and beyond compliance with the black letter of the law. The question this now begs is whether ethical guidance will move up a notch to align with its moral forebear.

# 3 The confluence of events affecting society, its morals and our ethics

Much has happened since the turn of the century to bring the subject of professional ethics in the accounting and tax trade to the attention of the media and broader public. These changes have highlighted a mismatch in the moral behaviour expected by the community of the profession, versus those sometimes demonstrated in practice (and played out in the media). This has led to the articulation of a growing number of ethical statements to which professionals in the field are now bound. Although some may argue that many ethical statements and principles are innocuous and already implicit "motherhood" statements, many will prove critical in establishing how roles in the profession are to be undertaken and the standard to which people will be rigorously held in the event of a scandal, failure or even a mismatch in the effective tax rate between two competitors in the same industry. The documents are publicly available, even actively promoted by some companies. The revenue authorities may well soon be holding the company's code in one hand, a transaction in the other and seeking assurance from the company that the two are aligned.

The ethical world of today is unlikely to look much like the one tomorrow, and many practices which are ethically sound right now are becoming increasingly immoral in the eyes of the public and will likely lead to adjustments to ethical guidance in years to come.

Arguably the first major events to accelerate the progression in ethical standards in the accounting industry were the major corporate collapses of the early 2000s, namely WorldCom and Enron, the latter leading to the disbandment of one of the Big Five accountancy firms. These collapses had a tax edge too. The fallout from these collapses precipitated the Sarbanes Oxley Act[1] ('Act') and the increase in rigour and documentation of internal controls. Many argued that the Act was an overreaction causing an unreasonable amount of extra administration. But alongside this era of internal control, accounting boards globally scrambled to restore faith and integrity to the profession through the issuing of clear ethical standards, and organisations articulated their own ethical codes as well.

Risk management and ethical practices again came to the forefront as the Global Financial Crisis emerged later in the decade. Corporate and individual greed and insufficient checks and balances are regularly mooted as the factors driving the greatest recession in recent memory and has heralded a new era of austerity and with it vocal scrutiny of those shirking their responsibility to clear up the mess left by the crisis.

Governments had run up huge fiscal deficits during periods of growth and struggled to deal with falling tax revenues, rising unemployment and debt and according deep cuts to public services. This environment of nervousness - at where the axe would fall first led eyes to observe the source of the problem and to critically assess the taxation system, and the morality behind its operation more closely than ever before. The spotlight shone on large global corporations and tax authorities around the world.

Aside the dissent expressed in Greece at the large extent of tax evasion underpinning their own financial crisis, some of the more dramatic developments in the tax morality space have so far happened in the United Kingdom. A cause championed by The Guardian, regular exposés were made by the newspaper on some of the country's largest organisations' tax affairs and tax avoidance structures, generally with information available in the public domain, and occasionally from leaks of sensitive information made from within organisations by disgruntled employees. Pressure groups such

[1] Sarbanes-Oxley Act of 2002

as UK Uncut and the Tax Justice Network have also now come into being and other established organisations such as Action Aid have championed tax justice as a key driver behind alleviation of poverty in the developing world. Tax avoidance has very quickly become a dirty word, and the morality of it in society's eyes is fast becoming quite clear and in stark contrast to what it had been in years gone by.

This examination of tax with a moral lens is now also playing out all over the world, including here in Australia. As organisations nationwide contemplate a future in which the ATO publishes information on their tax affairs, an increase in scrutiny and benchmarking of tax information evidences that the tax morality debate has well and truly reached Australian shores. It seems likely to follow the UK's lead, and may even lead the charge as Australia champions tax transparency of large corporates.

Just as global events and public opinion has impacted legislation and ethical standards in the past, the same is being witnessed in the present. The globalisation of business, in particular in the digital world, has moved forward at a pace that old taxation laws have not been able to keep up. This has enabled many global businesses to leverage tax arbitrage to reduce or eliminate taxable profits in jurisdictions where they earn substantial revenues and pay a higher rate of income tax. Alongside long-standing tax avoidance mechanisms, this has incensed the public further and has driven a domestic and international debate on the conduct of multinationals and the effectiveness of the law. After being tabled at G20 and G8 discussions, a mandate to review and bolster the international tax framework was sent to the OECD. In July, the OECD launched an action plan to counter Base Erosion and Profit Shifting (BEPS).

# 4 Emerging trends - when compliance with the law is not enough

The confluence of world events in the tax environment in recent years, culminating in its rise as a key moral issue and a potentially new tenet of Corporate Social Responsibility in the twenty-first century, have changed the rules as far as tax compliance is concerned. No longer do organisations simply have to concern themselves as to whether they have organised their affairs in accordance with the law, but instead a new and higher moral standard is imposed. The standard is intangible and fluid and is based on the vision of organisations paying their "fair share" of tax in the jurisdictions in which they operate, rather than simply handing over the legal amount.

This new trend is uncharted territory for the tax professional and underscores the transformation the tax industry is currently undergoing. In the past the financial consequences of a transaction being set aside were front of mind for those undertaking a deal. Now the reputational consequences of the transaction regardless of the outcome of a challenge (if any) by the tax authority might be of higher concern. It raises the question not only as to the effectiveness of the current rules in establishing a framework which reflects the moral judgments of society, but also even whether an organisation exploiting tax incentives clearly intended by Parliament is actually acting in a moral manner.

Monitoring global events and having regard to the growing number of corporate case studies in the media will be crucial in making the best decisions to preserve both the financial position and the reputation of the organisation. The world in which one makes a decision on whether to proceed with a tax transaction today may look entirely different to the world which goes through the transaction with a fine toothed comb some time from now, and decision makers should be fully informed and cognisant of this before deciding whether to take on a risk for which they may be held fully accountable by more than just the Board further down the line.

This same paradigm has confronted revenue authorities in scrutiny of their dealings with the largest businesses amid media and public accusations of double standards and sweetheart deals.

# 5 The evolution of the client and advisor relationship

Years ago, there would be no community or media backlash when faced with affirmative responses to questions such as:

- Is it acceptable for the taxpayer to minimise their tax costs provided they are doing so lawfully?
- Should the taxpayer engage in a transaction that results in payment of less tax, even though there are commercially reasonable and legitimate business reasons for the transaction?

Now, however the advisor must not only consider the commercial rationale for the transaction but also the risk and reputational damage (for both the advisor and the taxpayer) should the community, media and potentially the revenue authority, hold a different view as to the motivation for the transaction or structure.

The Starbucks case illustrates this point. In 2010, a group of activists in the UK formed an anti-austerity direct action group. It was this group that launched a campaign against Starbucks on the basis that it had paid a low amount of tax relative to its sales. The interesting part of this story is the community response and media attention resulted in Starbucks offering to make voluntary payments of £10m in each of 2013 and 2014 to the UK Revenue authority. This raises an interesting debate as to how such a voluntary payment could or would align with a Board's obligations to shareholders.

# 6 The evolution of tax ethics

Tax agents have a number of different ethical codes of conduct which govern their behaviour. Some are legislated such as the Code, while others are not, such as an employer's code of conduct. Depending on the qualifications or role, tax agents may also be required to comply with the legal professional conduct rules, the ICAA Code of Conduct for Directors/Board advisory committees, the 49 pages of the ASX's Corporate Governance Principles & Recommendations with 2010 Amendments, the Banking Industry's Code of Banking Practice, the Superannuation Industry's Code of Practice, IFAC's Code of Ethics for Professional Accountants, and so the list goes on.

In addition, Australia has legislated requirements prohibiting the promotion of tax exploitation schemes and prohibiting tax avoidance schemes. All these laws together with an employer's code of conduct, its mission statement and any additional industry code are designed to enforce ethical behaviour. The problem is that they are not updated at the same pace at which the community's morals evolve. In addition, much of the behaviour criticised in the media is entirely lawful and sometimes positively endorsed by the relevant revenue authority. Therefore, the courts cannot provide any recourse for the revenue authorities as there has been no breach of the law. While legal sanctions cannot be discounted, the real risk lies in the reputational damage for the tax advisor, the company and even the revenue authority.

Before the Code, State tax boards, the ICAA, law societies or institutes, the ATO and the OECD all promoted ethical behaviours. There were also provisions such as s251K and $L^2$, the requirement to maintain a 'reasonably arguable position', the common law requirement to take 'reasonable care' and consideration of whether the conduct or statement was 'false or misleading'. Over time more and more industry bodies, private companies and other stakeholders have required compliance with codes of conduct which promote ethical conduct (as it means to that group of people or stakeholders). The implementation of the Code in 2009 has not negated or deleted any of the other ethical obligations or behaviours to which tax advisors are bound. Rather, the Code has made punishment for unethical conduct easier to administer as there is now a clear framework, with clear penalties detailed in a document that can be held up to the public to describe what behaviour is acceptable, and what behaviour is not.

Individuals who provide "*tax agent services [as defined] for a fee or…engage in other conduct connected with providing such services*"[3] are required to be registered tax agents. Recently, the scope of the legislation has been extended to include financial advisors who provide taxation advice in connection with their services. This change will be effective from 1 July next year. In the future, it is anticipated that in house tax advisors will also be expected to become registered tax agents so as to ensure their compliance with the Code. The rationale being that this would, by default bind their employer to make "ethical" decisions about tax compliance, strategy and structuring. While such a step has not yet been foreshadowed by either the government or the Tax Practitioners Board it would provide a greater degree of oversight and consistency across all levels and functionality of tax advisor.

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[2] *Income Tax Assessment Act 1936 (Cth)*

[3] *Tax Agent Services Act 2009* (Cth) s 2-10(1)

# 7 TASA Code of Conduct

Tax agents have a legally binding Code of Professional Conduct. The Code is based on the community's expectations of what behaviour and attitudes are acceptable and expected from tax professionals.

In summary, those expectations require tax professionals to act with honesty and integrity, with independence, to preserve confidentiality, to provide competent services, to not knowingly obstruct the proper administration of the taxation laws, to advise of the rights and obligations that are materially related to the services provided and to respond to requests and directs from the Board in a timely, responsible and reasonable manner.[4]

The Tax Practitioners Board has recently released an exposure draft which, once finalised is intended to provide "information only"[5] in respect of what constitutes "reasonable care to ascertain a client's state of affairs"[6] and "reasonable care to ensure taxation laws are applied correctly"[7]. These exposure drafts have arisen in part because of the lack of clarity and certainty as to the meaning of these phrases within the context of this legislation.

In particular, the ethical debate surfaces where a tax advisor must "take reasonable care to ensure that taxation laws are applied correctly to the circumstances in which you are providing advice to a client."[8] While the concept of "reasonable care" has been widely considered by the courts, it can create internal, ethical and moral conflict as tax advisors grapple with it meaning compliance with the black letter of the law compared with compliance with the intent of the law. This friction arises largely because of the uncertainty of some of the legislative provisions in the taxation laws, which in turn raises questions as to whether the statutory interpretation should favour a literal interpretation or whether the tax advisor should consider all extrinsic material relevant to that particular section of the legislation before providing any advice. Although not immediately clear, on the face of it there are some benefits in maintaining a degree of uncertainty in interpreting the law.

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[4] *Tax Agent Services Act 2009* (Cth) s 30-10

[5] Exposure Draft TPB Information Sheet TPB(I) D17/201. Available from: <http://www.tpb.gov.au/TPB/Publications_and_legislation/ED/0531_TPB_I__D17_2013_CPC_Reasonable_care_to_ascertain_client_affairs.aspx> [8 November 2013]

[6] Ibid

[7] Exposure Draft TPB Information Sheet TPB(I) D18/2013. Available from: <http://www.tpb.gov.au/TPB/Publications_and_legislation/ED/0530_TPB_I__D18_2013_CPC_Reasonable_care_to_ensure_tax_laws_applied.aspx> [8 November 2013]

[8] *Tax Agent Services Act 2009* (Cth) s 30-10(10)

# 8 A conspiracy of uncertainty

All stakeholders in the Australian taxation system, i.e. governments, regulators, the revenue authority, tax intermediaries and advisors, taxpayers, courts and even the Court of Public Opinion are protagonists in the age-old game of cat and mouse that is the interpretation and administration of Australia's tax laws. Indeed there is inherent uncertainty in the drafting, administration and interpretation of tax legislation globally as well as locally. This uncertainty can never be completely eliminated, but there is arguably a benefit to all stakeholders in having the option of uncertainty up one's sleeve. For the taxpayer and its advisors, the benefits of uncertainty are clear in the spectrum of interpretations that exist within the letter of the law and the ability to use such interpretations to legally lower one's tax liability. Even for the revenue authority and governments, uncertainty enables one interpretation to work for one taxpayer and another to work for another taxpayer. The revenue authorities and taxpayers alike are therefore able to serve their interests by "running with the hares" on one case and "hunting with the hounds" on another in subscribing to literal interpretation of the words in the law or a broader purposive approach.

The public and the media are able to use the uncertainty in the tax law to draw their own conclusions from arrangements and stir up a controversy of moral dimensions regardless of the conclusions of the taxpayer, its advisors, the revenue authority or the government. The court of public opinion can often be more indicting and powerful than that of the land as far as a corporate's reputation is concerned. But the courts themselves are primarily bound to determine the parliamentary purpose through the black letter of the legislation and will only in more limited circumstances refer to extrinsic material to determine the complexity the legislation itself seeks to resolve.

In the context of the ATO's new approach to administering the large corporate tax base, common objectives for both sides were proposed through a trusting and enhanced relationship either by way of an Annual Compliance Arrangement or by improving the historically adversarial relationship between taxpayer and tax authority. By working towards mutual objectives in an environment of trust, the ATO sought to change the more abrasive rapport of the past. But the third stakeholder, being the public and press, adds new risk as a moral ombudsmen ensuring that the ATO is not too close to business in sponsoring state endorsed tax avoidance and the reputational risks for all parties are not to be ignored. Such was the case in recent years with HMRC and a number of perceived "sweetheart" deals with a number of large businesses in the United Kingdom.

As the enhanced relationship painstakingly develops between taxpayer and tax authority, increased certainty is offered as a reward for increased openness. The tax authority is more likely to accept a particular interpretation of an issue than they might be for a taxpayer who is uncooperative. In other words, the ATO may not want to remove uncertainty in the tax law, as it represents a deterrent option for those taxpayers who do not cooperate. To attempt to change aggressive behaviour, the ATO can reciprocate by leveraging uncertainty from the other end of the spectrum and arguing everything down to the last minor detail, to make playing the uncertainty game a costly one. Although one can argue that a statutory reduction in tax uncertainty would reduce the ATO's need to resort to its nuclear option, the ATO appears content to rely on the current approach to achieve its aim while keeping the old option and approach open. And so far the evidence is showing some degree of success in Australia.

# 9 Statutory Interpretation [running with the hares and hunting with the hounds]

As mentioned above, one of the contributing factors to uncertainty is statutory interpretation. Notwithstanding the assistance provided by the *Acts Interpretation Act 1901* (Cth) ("Interpretation Act"), statutory interpretation spans the literal, the purposive and the contextual. In *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355, McHugh, Gummow, Kirby and Hayne JJ noted:

> *"the duty of a court is to give the words of a statutory provision the meaning that the legislature is taken to have intended them to have. Ordinarily, that meaning (the legal meaning) will correspond with the grammatical meaning of the provision. But not always. The context of the words, the consequences of a literal or grammatical construction, the purpose of the statute or the canons of construction may require the words of a legislative provision to be read in a way that does not correspond with the literal or grammatical meaning."*[9]

In 2011 the Interpretation Act was amended, repealing section 15AA, "Regard to be had to purpose or object of Act" and replacing it with "Interpretation best achieving Act's purpose or object". This amendment has provided some additional guidance to the judiciary however the concern will never be completely alleviated.

The problems arising with statutory interpretation were recently illustrated in the Federal Court when Middleton J in *Commissioner of Taxation of the Commonwealth of Australia v Ludekens* [2013] FCA 142 interpreted Division 290 of the *Taxation Administration Act 1953* (Cth) differently to that of Allsop CJ, Gilmour and Gordon JJ in the appeal.[10]

Notwithstanding the extrinsic material that was able to be considered by virtue of section 15AB of the Interpretation Act this uncertainty could be better mitigated by legislatively mandating the precedence of the purpose/context over the literal interpretation regardless of the presence of ambiguity, and including a clear legislative statement of intent and purpose in all tax legislation. The purpose, context and intent could not then escape judicial or interpretative notice and both the taxpayer and the ATO could more constructively deal with taxation without the overshadowing uncertainty.

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[9] *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355 per McHugh, Gummow, Kirby and Hayne JJ at 384 [78].

[10] *Commissioner of Taxation v Ludekens [2013]* FCAFC 100

# 10 Managing tax risk

Usually delegated to the confines of the tax function, it is often forgotten that tax is something that touches on every transaction the business enters into. There are only so many places tax technical personnel can be at once, therefore to more effectively manage tax risk, the tax function has to establish, manage and monitor a robust and sustainable tax management framework of people, processes, systems, controls, training and feedback to gain optimum assurance that tax obligations are being fully met in accordance with the law and at a risk and value appetite that is reflective of the organisation's broader approach and articulated (tax) strategy. If a tax function is to manage its risks and act not only in a legal, but an ethical and a moral manner, it needs to ensure that its tax risk management framework is comprehensive, robust and operational.

The basics of good tax management are grounded in having the right approach supported by the appropriate execution. In governance circles, this can be considered as having the framework articulated first and in the right way, before it is properly followed – by taking reasonable steps to ensure it operates effectively. Putting the effort in to document a framework which is impeccable on paper, but which will never be followed in practice is a wasted effort. It is always better to consider the actual framework of activities as they operate today and then document them. In this respect, we observe the current execution and then consider its approach. This allows for room to improve and increase efficiencies in the future.

The operating models of many tax functions can be broken down as stated above first by their current execution followed by their approach. Within the execution, it is often simple to ascertain whether the tax function prefers to operate in an embedded or segregated manner i.e. do they interact with the rest of the business through established relationships, operating frameworks and information systems, or are they generally more isolated relying on the business to consult with them and using their own approaches and systems to collect and construct information? Equally is the framework executed by way of a formalised or intuitive framework, i.e. is tax managed following a defined and documented framework or does it follow a more flexible undocumented arrangement?

The status of execution on the embedded to segregated and formalised to intuitive spectra largely depends on the culture of the organisation, its ethics, its history and, in particular, its compatibility with the personalities in the tax function. Under a segregated operating model many who have tried to document their framework have failed. This is principally through not having engaged enough with the outside to make the framework embedded, and hence operational and successful beyond the confines of the tax function.

From an approach perspective, tax functions can be assessed by reference to an additional two spectra: value versus risk driven and a proactive versus reactive culture. Some personalities and corporate cultures tend to be more value focussed and others more focussed on risk, but owing to the nature of the profession, many tax functions, especially those under a segregated operating model, have more of a risk lens than a value one leading to, for example, highly skilled people being overly engaged in dealing with compliance concerns or picking up after the rest of the business, instead of seeking out value opportunities. There is, however, an argument that tax functions may increasingly have to be more risk-focused than in the past given the new level of moral scrutiny attached to tax affairs. The proactive to reactive continuum is fairly self-explanatory. A proactive and well-resourced tax function will actively manage risks and keep an eye out on the horizon for threats to the current operating model whereas a reactive tax function will deal with risks as they crystallise and are real issues. This cultural approach of proactive versus reactive can therefore have a dramatic effect on whether the function operates in the shadows fighting fires or is a prominent and respected business partner.

# 11 Strategic and operational risk

In the broader risk management framework, risk can often be broken down into different categories. Some schools of thought focus on where the impact of the risk will be felt e.g. financial and reputation risk while others focus on the field in which the risk resides e.g. health and safety, regulatory, finance etc. The ATO, in its Large Business Tax Compliance Booklet, set out some clear examples of the sorts of questions they would like organisations to ask in respect of their tax risk management arrangements. These questions are broken down into a strategic and operational perspective. Essentially, strategic boils down to the external directional movement of the organisation whereas operational focuses on the more routine internal workings of the organisation.

Any governance and risk management framework needs to contemplate and understand the entirety of strategic and operational tax risks that exist across the business. This involves looking at tax information flows and processes end-to-end and engaging with all personnel across the business that have tax duties, known as the Shadow Tax team. This includes, for example, personnel responsible for consulting with the tax function on tax issues and implementing instructions, or staff in the finance function who are responsible for coding and posting transactions to the correct income tax or GST sensitive code in the general ledger so their treatment is appropriately reflected by tax function personnel in the returns. Most tax functions are very proficient at managing the risks within their own backyard but often shy away from those "unknown unknowns" out in the business hoping for the best, and the ability to deny responsibility should something go wrong. This is not usually how management will interpret a tax failure and Heads of Tax should be proactive in dealing with this issue before it becomes an issue.

The ATO's strategic questions are as follows:

- Do you know how we categorise your business under our Risk Differentiation Framework? What are the consequences of your risk rating?
- Is your business effectively utilising the services and compliance products we offer to reduce your tax risk and compliance costs?
- Do you have processes to present the approach to tax risk for review by the Board?
- Do you know your advisor's risk stance and does their approach to risk align with that of your business?
- Does your business have any major disagreements with us? If so, are you satisfied with the way they are being managed? Have any potential additional tax liabilities been adequately provided for?
- Are the amounts of tax you are paying in line with your business results?
- Do you have transactions or arrangements that could be viewed as not making commercial sense or be perceived as seeking a tax benefit?
- Is there anything to indicate that your business results and tax payments are lower than would be suggested by economic conditions?
- If your business is consistently reporting losses, are these real economic losses and can they be satisfactorily explained in terms of overall performance?

The ATO's operational questions are as follows:

- Are the roles and responsibilities associated with overall tax compliance clearly defined?

- Does your tax function have adequate resources to manage tax risks effectively and provide reasonable assistance when dealing with us?
- Can you ensure that tax information used for your internal accounting or provided to us is accurate and reliable?
- Are you confident that your records and control systems enable you to meet your tax obligations properly?
- Is your business ensuring that its processes and procedures adapt to reflect changes to or court interpretations of the tax and superannuation laws?
- Do you have the necessary processes in place to assess and where relevant escalate matters to the appropriate level?
- Are there material differences between your accounting profit and taxable income and, if so, are you comfortable with the reasons for those differences?
- How do you ensure that your information systems provide ready access to important information and that there are no gaps in corporate memory?
- How do you ensure that reporting deadlines are met?

The ATO's questions are a good starting point from the perspective of assessing and dealing with strategic and operational tax risks. But they must now also be asked by reference to the other major stakeholders in the organisation's tax affairs: the media and public. At a strategic level, the perception of the organisation's tax affairs in the public eye may have a significant reputational impact if not appropriately understood and managed. Similarly, from an operational perspective if the organisation fails to implement sound tax controls leading to a systemic failure in calculating and paying taxes, how could this affect the reputation of the organisation if the story was leaked to the media? We consider some approaches to managing media perception later in this paper.

# 12 Three lines of defence

The 'three lines of defence' is a risk management model adopted in a business context by most organisations that have made progress in formulating and developing some kind of enterprise risk management framework. As the name suggests, the model is broken down into three lines which represent three different tiers of assurance an organisation can apply to mitigate and minimise risk – it comprises the elements of the framework that both articulate and document it, but also bring it to life through monitoring, and ensure it continuously evolves and improves through independent assurance and inspection.

The first line is the baseline framework of policies, processes, flowcharts and coalface activities undertaken across the organisation at a primary level to process information and manage risks. From a tax perspective this would include the tax governance policy document and any process and control activity documentation and flowcharts. It also includes the performance of the activities themselves, for it is this, not the documentation, that manages the risk.

The second line of defence is the level of monitoring activities over the first line of defence. Many suggest it is also the presence of a separate governance, risk and control function providing an additional layer of oversight over the first line of defence. The importance of the second line is that it provides a real time second independent tier of review. For example, to ensure a control is operating in finance around tax – for example a manager reviews all transactions into a tax sensitive general ledger code to ensure they are appropriate – a member of the tax team could independently review the evidence this control has taken place for a sample of transactions or dates. Monitoring does not necessarily reperform controls; they are there to ensure that control activities are taking place and that performance indicators are operating within preset levels.

The third and final line of defence is the independent assurance one obtains over either the governance framework or the output of it. This includes the external audit, any internal audits and any other subject matter expertise reviews of items such as a tax technical review of a particular transaction to ensure that the conclusions derived from the facts are sound. Generally speaking, the difference between the second and third lines of defence is timing. The second line operates alongside the first whereas the third line of deference is usually a separate review after the event. One therefore does not want to rely on the third line of defence to get things right as it is often too late from a tax perspective to change already submitted returns once the independent review has concluded. The third line of defence is, like the second line, a deterrent mechanism in helping to enforce policies where individuals know their work is going to be reviewed. It will also pick up material errors which may need readjustment. Finally it takes a holistic look at the framework itself and recommends improvements as a value add.

If a tax governance framework has any likelihood of being sustainable and operational, sound advice would be to apply the principles of the three lines of defence to bring it to life. The first step would be to engage with broader risk management personnel across the business to understand the already existing framework and how tax can embed itself into this. This can be the protocols to identify, assess, quantify and monitor risks holistically, as well as following the same templates and approach to document and formalise processes, including those performed outside the tax function. Not only can the principles of the three lines of defence then be applied to the tax context to galvanise the framework, but insight can be gained into already operational activities into which tax can be embedded e.g. monitoring activities performed by the finance function or request internal audit consider some key tax issues in an audit of a business unit. This also presents the opportunity to outsource some of the risk-based activities outside of the tax function to enable skilled personnel to focus on value activities, but will also open up a dialogue and raise the profile of tax, as a key

commercial driver, and now moral issue with reputational bite. It needs to be managed by all, not just by tax.

The historic issue with tax and the three lines of defence has been tax's tendency to be segregated from the business more generally. This has meant that many of the lines of defence that could be present for tax have been missing, both within the tax function and out in the broader business. As organisations develop and evolve, and tax functions increasingly embed themselves into broader enterprise risk management framework and its three lines of defence model, the next step will be to ensure that the ethical and moral questions around tax are considered. Ethical guidance already in place should be reflected in policies which themselves should be subject to second and third line of defence assurance.

Equally, from a moral perspective comes the increasing reputational risk around tax. Involvement of other stakeholders in the business including risk and internal audit functions, i.e. second and third lines of defence, are important in successfully quantifying the reputational risk in perception, and the best strategies to approach it. When it comes to the evolving story of tax morality and management of the risks behind it, three lines of defence undoubtedly remain better than one.

# 13 Legacy and current tax risks and issues

Moving along the governance and maturity journey towards a robust operating model to deliver value and manage risk from a tax perspective is fraught with potholes. It is also likely that legacy issues left on the side of the road long ago will hitchhike back to rendezvous with a taxpayer in the present. This is why having a plan to deal with legacy issues and assess their impact on evolving relationships with both revenue authorities and the public is important. Should an organisation choose to issue a tax governance policy providing ethical principles in terms of the way they will seek to pay their taxes, the revenue authority may seek to hold them to account in respect of these legacy deals entered into long before the principles were contemplated.

Similarly if the taxpayer makes its principles public, this demonstrates good corporate citizenship and can foster trust with the public and customers. However a spat in the courts over a legacy tax transaction can soon undo the good work done and present the company in an even more negative light than if it had said nothing. There are many recent case studies underlining this where significant damage was done to the corporate brand. Regardless of whether tax disclosures are made, an organisation with a great Corporate Social Responsibility record may do damage to this record by being perceived to have engaged in tax avoidance. Legacy issues not only within the organisation but also within acquired businesses should therefore be clearly understood and a proactive plan put into place to manage them and any potential risk to the corporate brand.

# 14 Responding to media enquiries

Media enquiries are no longer limited to enquiries from trained journalists who permit you to call them back with a written statement or premeditated response. Responses are also required to queries originating from Facebook, Twitter, the blogesphere, pressure groups such as the Tax Justice Network and even Instagram. In a more recent example, a journalist in the United Kingdom posed as an independent tax consultant and asked advisors from some of the Big 4 accounting firms how best to minimise his "client's" tax.[11]

In light of the changing face of enquiry both companies and advisors should consider undertaking research to devise a strategy to approach media. With the ATO's upcoming publication of taxpayer information in mind, now is the appropriate time to:

- Benchmark data to any available or presumed information to be published on peers
- Understand what information will be published by the ATO for the tax year in question
- Critically analyse the information to understand how the media may choose to interpret it in isolation of the full facts – what is the risk?
- Proactively consider a response to any anticipated media scrutiny in consultation with media consultants, and consider the release of additional disclosures on tax prior to the ATO publication date
- Examine other cases of media interest in corporate tax affairs around the world
- Conduct public domain analysis of company's tax information to understand the profile of the organisation in full, and other reports the press may seek to make.

[11] Brooks, R 2013 'Tax Lies and Videotape; Britain's Shadow Tax System Revealed' *Private Eye*, pp 19-22.

# 15 Conclusion

A key contributor to the debate of ethics and morality in relation to tax is the inherent uncertainty in the tax law. At the epicentre of that uncertainty is the spectrum of approaches available to all stakeholders (taxpayers, the judiciary, advisers/intermediaries and revenue authorities alike) in regard to statutory interpretation of revenue legislation, which is evidenced in case law.

From a statutory interpretation perspective it is open to run with the hares and hunt with the hounds depending on the outcome sought to be maintained, often in elements of degree. A framework of tax ethics based on tax law subject to a wide spectrum of statutory interpretation is a house built on sand, perhaps intentionally so, to move with the shifting tide of community opinion.

This spectrum of statutory interpretation prevails in the absence of a mandated requirement that all revenue legislation be the subject of interpretation by reference to its intended purpose as evidenced in all the extrinsic material as well as the ordinary meaning of the words of the statute in which they appear and, where appropriate, tax legislation should be supported by clearly articulated purpose and intent within the legislation itself.

As media scrutiny and greater transparency increases company accountability tax advisors need to think beyond the black and white of tax compliance. A new multi-faceted approach to tax is here and there is no shortage of pressure groups to remind us. It is prudent that companies establish an appropriate governance framework with three lines of defence and proactively manage their relationship with the ATO. Companies must consider and take appropriate steps to mitigate reputational risk and damage. The difficulty is that companies can't just consider transactions or advice in light of the current community attitudes, but must also engage in crystal ball gazing and think about the community perception five years from now. The best solution to this problem is to interrogate the facts and circumstances and fully understand and substantiate the commercial drivers for such a transaction or advice.

It was Benjamin Franklin who once said that nothing in life is certain, except death and taxes. It is quite ironic therefore that it is the inherent and pervasive uncertainty in tax which now drives the debate we have about its future. The next clear step towards the certainty is likely to be a more sustainable code of tax ethics demanding greater clarity in relation to tax law, and the removal of flexibility in interpreting the law to run with the hares and hunt with the hounds. But the quest to eliminate uncertainty from the tax system completely is likely to outlive us all.