Corporate tax governance

Module B

Expert views on corporate (tax) governance

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Expert views on corporate (tax) governance by Professor Mervyn King, Professor Jaap Winter and Professor Leen Paape.

*This module provides three expert perspectives on tax governance developments by corporate governance experts Professor Mervyn King, Professor Jaap Winter and Professor Leen Paape. The module is a supplement to PwC's Tax governance publication which can be found at **pwc.nl***

Prof. Mervyn King

Expert perspective by Prof Mervyn King

Professor Mervyn E. King is an international authority in the area of corporate governance and corporate citizenship. Prof King is a former judge of the Supreme Court in South Africa, and best known for chairing the King Committee on Corporate Governance, which issued several comprehensive reports endorsing an integrated and inclusive approach to corporate governance. Compliance with the King Reports on corporate governance – known as King I, II, III and IV – is a requirement for companies listed on the JSE, the stock exchange of South Africa.

Prof. King about tax:

"Tax has become a complex matter with various dimensions. The governing body should be responsible for a tax policy that is compliant with the applicable laws, but that is also congruent with responsible corporate citizenship, and that takes account of reputational repercussions. Hence, responsible and transparent tax policy is put forward as a corporate citizenship consideration in King IV.

Prof. King about good governance:

"Good governance is about changing behavior. Governance became mindless compliance, without added value. We should avoid that taxation is no more than a mindless tick box exercise."

How did taxation enter into the King Report?

Taxation is very compliance driven, and has been so for more than 100 years. In considering the King IV report, we came to the conclusion that the tax policy of a company should be transparent and responsible. So that means that a company must be and must be seen as a good corporate citizen. For example, it's not good corporate citizenship if a foreign company avoids paying taxes in South Africa, but still uses the infrastructure of the country which have been paid for by South African taxpayers.

Now, through a combination of automatic exchange of information and country by country reporting, there is no way anymore – from an avoidance point of view - to hide income away in the corporate closet. You should be seen as a company that is responsible in their tax policy.

We also found in our discussions with many stakeholders that employees today are pressuring their companies to make sure the company they work for is seen as a good corporate citizen in the country. That's a significant difference with five years ago. The driver for most companies five years ago was to pay as little tax as possible, not a fair amount of taxation for using the infrastructure of a country.

With this in mind, we came to the conclusion that tax policy is a matter for consideration by the board. Because it's a critical factor for external stakeholders. They can conclude if the company is a good corporate citizen or not.

King IV has gone from rules-based to outcome based. Steering a company on outcome instead of relying on rules. That's a big shift in thinking.

Why is the integrated thinking approach so important in King IV?

Integrated thinking is the heart of King IV. We see similar approaches everywhere. Take a look at Ghana, where they set up a new integrated thinking approach. This is the new standard.

We have started moving from Milton Friedman's free economy profits to a value creation process. Value today is seen through a value creation lens; it is no longer looked at just through a financial lens. This perspective is in fact in the better long-term interest of all stakeholders, for society and for our planet. When you adopt an integrated approach, which is more value based, you gain the most benefits. Companies can borrow capital more cheaply, they attract millennials who wish to work for a company that includes ESG[1]-factors and correct the state of the planet instead of a company that does business as usual."

So, integrated thinking is starting to gain traction all around the world. But you need a change in mindset at most boards today. Most boards are still locked into that short-term mindset. That's why the CFO becomes critical today: he or she does not only deal with financial matters and is the true change maker inside the company. Consequently he or she should rather be known as the Chief Value Officer.

1 ESG refers to Environmental, Social and Governance.

Prof. Jaap Winter

Expert perspective by Prof Jaap Winter

Professor Jaap Winter is one of Europe's leading corporate governance experts. He was a member of the Tabaksblat Committee that drafted the first Dutch Corporate Governance Code in 2003 and he chaired the High Level Group of Company Law Experts that advised the EU Commission on Corporate Law and Corporate Governance in the EU in 2001-2002. Amongst others, Prof Winter is a professor of corporate law, governance and behaviour at the Vrije Universiteit Amsterdam and distinguished visiting professor of corporate governance at INSEAD. Prof Winter has for years worked as a corporate lawyer and is currently a Partner at advisory firm Phyleon, where he advises boards and leadership on governance matters and board dynamics. Prof Winter holds seats in supervisory boards of several Dutch foundations and companies, among which Dutch multinational company Randstad.

Do the corporate governance rules work properly?

In general terms, one can say that corporate governance codes have helped to raise awareness of the importance of careful governance. In this respect, I think having rules has helped. The use of best practices according to the "comply or explain" principle, however, seems to be less effective. This approach is being applied too formalistically, in order to avoid having to explain why something was done the way it is done. As a result, there seems to be a lack of substance in application of the comply or explain principle, and there are no checks and balances to it.

What would be the answer to this? Should more rules be imposed?

If current rules do not work, imposing even more rules will not be the answer. You will not be able to enforce or achieve desired behaviour simply by imposing additional measures. This is the intrinsic limitation of regulation. It is then up to the parties involved to come up with a solution on how to shape their governance. Executive and Supervisory Directors should clarify how they see their respective roles.

Roles – collaborative leadership

We also have to accept that not everything can be covered by a set of rules. If we go and formalise everything, it brings human interaction - however essential - to a standstill. Moreover, it is not the intention to make every element of governance completely defined and transparent. That is neither realistic nor necessary. If you do that, you may end up with some sort of "boilerplate disclosures" about how things are going, without making clear how they are actually going. This increases the risk that formalities end up determining content, so that an impoverished reality is thus created.

Has there been a change in the role of Supervisory Boards as regards governance?

Due to an increasing focus on corporate governance, the role of Supervisory Boards has changed substantially, mainly due to the strengthening of their monitoring role. The role of Supervisory Boards used to be mainly focused on internal supervision and correct annual financial statements, however, since the financial crisis " risk management has been added to the list. Supervisory Boards are now monitoring the activities of the Executive Board more closely. Moreover, Supervisory Boards who take their monitoring role seriously also want to be involved in key decision-making processes by the Executive Board at an early stage. They realise that they will be too late if they are only confronted with the "here and now" figures, reflecting a policy that was put in place a few years ago, but which they can no longer influence. This is also prompted by the increasing expectations of the outside world, to which they want to be able to respond. This sometimes leads to friction between Supervisory Board and Executive Board. Closer involvement of the Supervisory Board requires more role clarity between Supervisory Board and Executive Board. It does indicate that the role of the Supervisory Board is becoming increasingly important.

What does the shift from shareholder value to stakeholder value mean as regards companies' tax behaviour?

This shift facilitates that development regarding the tax behaviour of companies is gaining momentum. We all have to pay our taxes and companies should not structurally avoid taxes only to create greater value for shareholders. If companies take the pressure off by not only being concerned with shareholder value but also behaving as responsible corporate citizens, this will lead to a different orientation, including in the area of taxation. Structures and tax positions will then be critically assessed: "Are they in fact appropriate for our business?" "Don't we just reap the rewards and get others to carry the costs?" This will lead to companies making different decisions.

How could that kind of behaviour be encouraged?

Companies should individually formulate – explicitly – what is a responsible level of taxes paid by them, also being participants in the societies in which they operate. They need to establish a few basic principles that they subsequently adhere to, for example, not setting up any structures that have no substance and are set up with the mere aim of avoiding taxation. What this actually means is that companies should publish their own Codes of Tax Conduct on the company website. The advantage of such an approach is that the companies can be held to their own principles. It means that companies can be monitored by stakeholders according to the principles of their own tax policies. There are also various ways - for example through an audit - to check whether they really adhere to them.

And there is another important aspect. Most companies do not actually want to operate by "cutting corners". But if their financial situation is poor, the temptation may become stronger to keep its head above water. If that conflicts with the key principles as laid down in the company's own tax policy, the company runs a high risk of being corrected, which will be hard to explain to the general public.

Prof. Leen Paape

Expert perspective by Prof Leen Paape

Professor Leen Paape is one of Europe's leading corporate governance experts. He is the Chairman of the Nyenrode Corporate Governance Institute and has worked for years as auditor at KPMG and KLM and as partner with PwC. Prof Paape is currently Supervisor for the Goldschmeding Foundation. In addition, he is Chairman of the Supervisory Board of Unive Dichtbij, Chairman of the Foundation Board of the pension fund of SNS Reaal, Chairman of the Identification Board of NBA and Chairman of the Practical Training Council of NBA. Prof Paape has written numerous publications on corporate governance and holds classes on corporate governance for executive and supervisory board members.

Prof Paape about tax:

In relation to tax, there are three elements important to take into account. First is the opinion of Professor Mervyn King, who has been a great advocate of integrated thinking, and emphasized this way of thinking as the basis for integrated reporting. Second is the view of Feike Sijbesma who recently said that if you, as a corporate, do not contribute to solving (societal) problems, you have to ask yourself whether you have a license to operate. Third is the standpoint of Jaap Winter, who is now advocating to integrate the corporate purpose and corporate responsibility in law. I strongly agree with all of these views and believe this also has an impact on the world of tax.

For corporate tax planning, for example, I think it is important to consider both the purpose and the spirit of the law. Although I understand one has a right to optimise tax (structures), there is also a moral angle that has to be taken into account. In this regard, it can be quite complex to find a balance between legally allowed optimisation on the one hand, which might be considered by some stakeholders as 'aggressive' tax planning or avoidance, and paying a fair share of tax on the other hand. It is, however, necessary and important to carefully find and govern this balance.

What do the above three views mean for the tax system?

On a country level, it is important to determine how society can be funded long-term. It is a fact that a certain funding amount through taxation is needed. In this regard, a fundamental question is how our tax system can be designed in such a way that it can fund public goods and services, address modern society expectations about tax fairness and at the same time steer sustainable behaviour of organisations, business, individuals, and the government. For this, a tax system re-set seems to be needed which can only be done if various stakeholders work together with a long-term systems view. This includes discussion on many dilemmas including amongst others the taxation base, balance between moral and legal approach to tax, responsible tax planning, good tax governance, transparency and more.

Without such a fundamental and long-term approach, we more or less remain 'stuck' in ad hoc discussions, and (non-systemic) short-term solutions, based on single views. Parallel, it is important to create an international level playing field as much as possible and contribute to the further development of the global tax system. This is not an easy task but again necessary.

What is the role of transparency in this?

On transparency for tax, I consider it of great value that organisations open up more regarding their tax affairs. Also if it is not (yet) regulated in law. Various stakeholders ask for transparency on tax. This is also rooted in the perception some stakeholders have that taxpayers, who are not transparent, may behave irresponsibly tax wise and therefore may not want to disclose their tax behaviour. I see, however, a rise in transparency with published tax strategies, narratives and tax contribution reports. In my view, this contributes to long-term value creation, as it is part of integrated reporting, helps to show accountability and enables stakeholders to make informed decisions.

Has there been a change in boardrooms regarding tax?

In boardrooms the attention for tax is certainly changing. Tax is more often a topic on the agenda, although often still incident driven. The effective tax rate remains a 'classical' key performance indicator, but there is more attention for 'how we steer and manage tax' in general, including tax transparency reporting.

In the Financial Services sector, due to integrity regulations and guidance from the Dutch Central Bank, there is a lot of attention, also at board level, for (tax) integrity in client due diligence, but in essence, this is a backlog. Institutions did not always have detailed information on their clients and how products and services were used, and that is now changing. Also here you can see the systems view, where institutions are being asked to oversee the (tax) impact of the entire organisation, including their clients, products and services and more.

What is your takeaway for board members?

Board members have the authority and power to steer and ask questions, also on tax behaviour. My request would be to take responsibility and start the discussion on what is responsible tax and appropriate governance, also in light of the corporate purpose, sustainable business strategy and transparency approach. This is a process that may take time, also in discussion with various stakeholders, but it will certainly contribute to the long-term value creation for the organisation itself and for the societal system in which it operates.

How PwC can help

To have a deeper discussion on tax governance, please contact.

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