Tax Matters

Loughlin Hickey is the Global Head of Tax of KPMG. He has been recognized as No.1 in the Tax Business Magazine, UK, in their list of top 50 most influential people in the tax world. He is the author of several publications including The Philosophy of Tax, Tax and CSR, and Tax and Environment. Loughlin brought to light the minutiae of taxation from his industry experience spanning over 25 years, in conversation with Business Today during his brief visit to Sri Lanka.

By Keith Bernard Complied by Manisha Wijegoonawardena Photography by Menaka Aravinda

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Could you explain the purpose of your visit to Sri Lanka as a member of KPMG's Global Executive Team?

Part of my job is to connect KPMG member firms to each other. We can learn from each other and share global experiences. This is why I am here, I want to learn from Sri Lanka and share it elsewhere. I am like a connection point. I can share with Sri Lanka experiences from other countries and vice versa. My main task is to make sure that KPMG has a global mindset, which means learning from each other and not dictating from the centre.

From your experience and insights how would you articulate the development of the acceptance of tax as an area of strategic significance by companies?

This acceptance has been a gradual process or to be precise it has not happened overnight. The current crisis has made people aware that in order to overcome the crisis governments have used the tax systems as a stimulus. People have understood that tax is an instrument of economic policy since the government uses tax incentives to encourage investment. In turn governments have realised that making tax processes complicated will make it more difficult to implement them. From a corporates' perspective, they have come to realise that governments are requesting them to contribute to the recovery through economic policy.

Corporates do this in two ways. Firstly, to ensure that they are contributing in terms of tax revenues. Secondly, in giving confidence to governments, that they have been open with them. The unfortunate thing about this crisis is that the general public is challenging whether large businesses are being as transparent as they should have been, on the contrary large businesses feel that they are now being asked to justify their presence. Companies are facing a strategic issue of demonstrating to their shareholders, regulators and customers that they are good corporate citizens and that they are helping the country. This results in financial issues or questions such as, ‘are companies managing their tax sensibly ?’ Also ‘are they demonstrating that they respect and are complying with government policies?’ These issues will result in financial risk, process risk and a reputational risk. It’s also strategic to ensure that shareholders are only paying the tax that was due and not being forced into paying taxes that are not due. That’s what has really made it strategic because people have begun to realise that tax is part of economic policy and therefore also part of corporate policy.

“Organisations Need To Help Their Tax Departments Move From ‘Fire-Fighting’ To ‘Fire Resistant And Fire Prevention’ Through Invesments In Technology, Processes And People.”

Are you suggesting that a practice that has been evolving over a decade or two has suddenly been triggered because of a financial crisis that we have faced within the last 2 or 3 years?

That’s exactly correct. This has been a trend going on behind the scenes with more progress being made in the last 4-5 years. The reason for this trend to continue is that governments and tax authorities have to do more with less because they’re the ones being squeezed for cost and investment. Thus, they are working out how to allocate resources. Companies are beginning to realise that there are too many disputes that haven’t been resolved. Therefore, behind the scenes there have been moves for tax authorities and corporates to establish what is known as an ‘enhanced relationship.’ It has been a slow and difficult process. The use and effectiveness of the tax system and the way it is administered has been elevated through this crisis, but the good thing is that since a substantial amount of work has been done in the period leading up to the crisis, there is a chance of this process being successful.

Do you think there is high potential and acceptance by boards of

companies around the world to bring tax in to the boardroom, if so, why?

There are two answers for that question. Boards might say, “There’s enough discussions on tax in the boardroom.” The other answer is, “tax not in the boardroom because we don’t want to discuss it there.” There are no clear-cut right or wrong answers to offer. But it’s clear to me through surveys and discussions with companies and tax authorities that there’s a surge within the last year of boards wanting to ask more questions from their tax departments. It had not been properly looked at in the boardroom to date. Increasingly, tax has been a topic of discussion in the boardroom, firstly for reassurance and secondly to make the investments that enable that reassurance that not only are risks being managed but also that tax is adding other value to the business. We have identified that tax departments within organisations work very hard with less staff to do things right as tax laws have become more complex with globalisation. Organisations need to help their tax departments move from ‘fire-fighting’ to ‘fire resistant and fire prevention’ through invesments in technology, processes and people. In short they need to be more forward thinking. Therefore I feel that tax has not been brought to the boardroom as much as it should be. The boards have not been asking the right questions and allocating sufficient investment dollars into tax processes. This will change in the future because it’s been a long time coming.

In your view do you think tax is a subject that warrants inclusion in the Board agenda, or something best left offline to be taken care of by the CFO?

In terms of the technical detail of tax and the identification of risks this has been dealt with very well by the tax departments and the CFOs. In previous times, I would call it a hygiene issue, for example you mean to get it right; you assume you’re getting it right, and whilst there’s some argument, you tend to settle it. That was how it worked therefore it wasn’t a big issue. It is not so in recent years, when people are saying, “there’s much more interaction between public and private sectors.” In a strategic point of view, if you want to work with governments it is important to make sure that you maintain a good reputation. Governments have begun to realise that sustainable tax revenues are an important part of economic policy primarily because we have gone into a crisis and managed to slowly come out of it. They have also come to recoginse that they can’t simply bully companies into paying money, because the world is very global, companies can go elsewhere.

It was fine whilst tax was a technical hygiene issue but now it has become a strategic issue where the CFO can lead the debate since they are best placed to do it but also, this debate needs to be held by the board and the audit committee because it has become a strategic debate. The board should now decide whether this is what they want to do and how they intend to manage risk and create value as well as how they will invest in there tax department to make that work.

“I Have Great Confidence In The Business Ability Of The Board But I Fear That They Have Not Applied The Same Business Logic And Discipline To Tax As They Have Done To Marketing, Purchasing, Production, R&D And Technology.”

How do you think a company can benefit from bringing tax to the boardroom?

I have great confidence in the business ability of the board but I fear that they have not applied the same business logic and discipline to tax as they have done to marketing, purchasing, production, R&D and technology. It’s a very technical subject but so are most parts of a thriving and complex business. In my opinion what is lacking is, the combination of technical skill of the tax department and the financial skill of the CFO combined with the broad business and strategic skills of boards, to make tax part of driving business value.

In your opinion, is it more likely that companies from industries that are subject to high taxes, such as alcohol beverages, may consider taxes to be of higher strategic significance than others?

The closer tax is to business the more important it is to them. For example, if you have an excise duty, it’s obvious and sometimes very costly. Therefore it affects the way you approach the market place and it affects your competitive stance. Excise duties are looked at in a very different way, due to their visibility. They’re a clear cost of production, therefore a component of market pricing and profitability. It is directly related to how you make business profits. But what people forget is that corporate taxes are a burden on the business and they are a price driver as well. Indirect taxes that flow through costs a large amount to administer and also affect market pricing. People focus on excise duties because it’s closer to the business. However, all taxes are a burden on the business, the difference is that they are unrecognized in many cases as affecting business decision making.

Those who believe in creating value through tax may, for example, plan well-executed disposals or set up operations in tax havens as done by some fund managers. Would such motives count as good reasons for tax forming a part of the Board Agenda?

We have to look at it logically as use of the world tax havens creates a lot of emotion. Tax is a part of economic policy, governments use tax as incentive for investment. If I create tax holidays and people take advantage of it, is that tax avoidance or tax evasion? It's neither, it's responding to a direct incentive for investment. I feel there are many myths around tax havens, it is because some small countries have used tax as a competitive lever because other countries are bigger or more established. They are trying to use as many levers as possible, in my opinion the only point that needs to be made is that if you do something for business purposes and accessing a low tax rate, be it through a low cost country or tax incentive in a country, it is okay as long as you are transparent about what you're doing. It is unacceptable to say, "It's none of your business and I'm not telling you why it's a part of my business operation." Accessing incentives deliberately designed to create wealth and investment in the country is absolutely fine because if it doesn't work then economic policy doesn't work. As long as it's driven by an overall return on investment, governments should encourage it because where there are risk premiums for investment in some countries, that can sometimes be offset by tax incentives, until such time as the returns on investment are sustainable and the incentives are no longer necessary.

Do you have plans to go to another offshore site and contribute to that economy?

Many multinationals will try and get access to capital at the lowest price and maximise their returns. If a multinational company invests through low tax regimes , such as Hong Kong or Singapore, no one would suggest that they're awful tax havens. By paying less tax and generating more profit, they will earn more money to invest elsewhere. If there are business opportunities, they would not keep the money in Singapore or Hong Kong. The profits and investments will go to a country where there is the best return on investment and in deciding that they will also consider whether there is strong rule of law, equality of treatment under the law and the tax system is fair and not too costly to administer. The tax system should be consistent, transparent and willing to understand what motivates business to invest and keep on investing. I don’t see that having assets in a low tax county is an issue, provided that it is made as a sensible business decision.

Boards are forced to comply with regulations connected with Corporate Governance and if persuaded, to also discuss and report on matters concerning tax as a matter of compliance. They may be overwhelmed with discussions related to compliance and less on the big picture and direction. How do you see the issue evolving?

I think it’s a potential mismatch. The detail of tax is not a boardroom issue. It is easier to make tax a boardroom and business issue, therefore you should use business principles. I think corporate governance is a good business principle to apply to tax. We would need to ensure that there is a clear policy, reassurance that the systems and processes oversee that these are carried out and that there are sufficient internal controls as well as independent checks within the company. That is what the board should be concerned with- setting in place the framework and then assuming that the processes and systems deal with them. This is important because you use tax as a strategic issue, which is to say, “Is the way I look at tax and then manage tax the same as the way I’ve administered the rest of the business, under my corporate governance principles?” If it is, that’s fine. If I invest time in the boardroom to get my corporate governance principles right for tax, I want to get more trust and less intrusion from a tax authority because I’ve made the investments in my systems. We need to get both in balance; if a business invests in governance principles for tax and is able to explain them, the tax authority should trust those investments to deliver and therefore scale down intrusions and make it less costly to interact with them.

Tax authorities are under pressure; they have to allocate their resources to invest in the best return on allocation of those resources (which could include allocating resources to train their people to the highest level), which is good business practice. It’s not only for the tax authority but for the country as well. Assuming I’m a taxpayer company, the tax authority has highly trained specialists who understand business who interact with me. Not only will I feel that my taxes are fair, I will feel like I’m working in a country where I would like to invest more. It will not work if you have a tax authority whose sole aim is to raise as much money as possible. If the tax authority does it in such a way that the business feels that this is not a good investment environment, it’s not just the tax authorities that suffer but the whole economy.

“The tax system should be consistent, transparent and willing to understand what motivates business to invest and keep on investing.”

Despite the growing awareness by companies of the strategic value of tax, it has actually become more complex and demanding over the years, hence relegated to a specialist department instead of being discussed at board level due to difficulties of comprehension. Do you think that is a fair assessment?

It is a fair assessment and also a self-fulfilling prophecy. Governments cannot introduce business friendly laws unless they understand better what motivates businesses. Businesses must interact with governments to build a trusting relationship about what it is that’s important. It is obvious that you’ll get more and more technical because the company will deal with it, either through using a tax department or outside advisors and the cost is almost hidden, but if that carries on, it just gets worse. In reality, a government wants an economic policy, which includes tax and they assume that the tax policy attracts the businesses. They assume their policies can be implemented through the business. What I believe is that if the boards take more of an interest in the way that tax policy is formulated and signal to governments that they have systems in place to make sure that they’re doing it for the right reasons, you will find that the tax law and policy will become clearer. The government will invest in the tax administration to make sure that we’ve got the right skills and processes. The company will invest in the right skills and processes to make sure that they have a good relationship. Then, what we find is that we can have a much more simple system, because people are working on the principles rather than working on law after law to raise taxes in the short term. If I were in a tax authority, I would want my finance ministry to appreciate the work I do and invest in it just as if I was in a tax department in a company I would want the CFO and the Board to recognize the value I can create (including management of financial and reputational risk) and invest to enable me to create that value for the business.

Besides the taxpayers and revenue authorities, the tax advisors to companies also play a significant role in the overall tax process. In your

view and from your experience, do you think the tax advisors are more swayed to help clients avoid errors and deter them from engaging in unlawful or overly aggressive tax minimisation or in designing aggressive tax planning?

I was in Beijing last year, talking to the tax authorities there and they asked this, “Mr. Hickey can you please explain, how you can satisfy your clients and make us happy at the same time?” Which is very much the same question you’re asking. What we see is more about common needs than individual differences. Companies want to invest in your country and they can only do so if they comply with your laws. Our job as tax advisors is to help you to make laws that attract businesses that they can comply with, and encourage businesses to understand their obligations. If I do my job well, I can bring corporates and governments closer together to make the investments that help create profits and wealth that provide a broader tax base and is good for both because it creates a sustainable virtuous cycle.

The OECD, which is a global body of tax administrations, issued a report a couple of years ago about how you should behave. KPMG was the firm, globally, that issued a report to make sure that people would be encouraged to read it. Since it was a 170-page document, KPMG produced a summary of it, a debating point to really encourage the dialogue, because our job is to bring people together and not to hold them apart. If we see our role as being respected by our clients and governments through helping them to come together then I think we are adding real value to what we do for countries around the world.

“I Believe That The Officers In The Tax Authorities Are Professionals And That Everyone Should Be Governed By The Same Principles And Codes Of Conduct.”

As much as there may be a duty and obligation on the part of the taxpayer to comply with the law, there is also an obligation on the part of the revenue authority to offer a professional, fair and efficient service and perhaps themselves be subjected to be rated in a corporate responsibility index. Do you have a view on this matter?

I have a very clear view, if you want a relationship of respect and trust you must be governed by the same principles. In fact in one of the business papers I edited, KPMG tax business for a code of conduct in the tax arena, we put forward that there should be a common code for all tax professionals. I believe that the officers in the tax authorities are professionals and that everyone should be governed by the same principles and codes of conduct.

There is a development towards consolidating direct and indirect taxes, for instance, the combination of information previously held separately between the tax and customs administrations. This has important implications for taxpayers and provides higher efficiency of revenue administration by the State. Do you see this development gaining momentum in other parts of the world?

It is happening in other parts of the world for two reasons: Firstly because it's more efficient. If I'm a business it's much more efficient for me to deal with one point of contact rather than multiple points of contact. That's why it is moving in the direction of all taxes effecting the corporate, which includes administering wage taxes. It is much easier to have a representative in the tax authority; their job is to send me the specialists to deal with my concerns. In return my job is to assemble my corporate specialist to deal with them. I think it is a trend that is sometimes difficult on customs. Customs is broader than trade, and some people put customs as part of border protection/homeland security. There is a rationale for customs, which in many cases deal with issues such as smuggling and concealment, seen to be more about security issues, most times, rather than being principally a tax issue.

In 2006, 10 countries formed what is called the "Leeds Castle" Group to meet regularly and discuss national and international tax administration to provide mutual assistance. Authorities are also employing technology, for instance the so-called "spider" programme to mine the Internet for evidence of taxpayer economic activity. How effective, in your opinion, has such international collaboration proved to be?

It's been very effective. The Leeds Castle Group is a subset of the OECD, since people were concerned about the pace of change and getting all these countries to agree. I think there is growing acceptance that the broader group is now capable of moving more quickly and effectively. Tax authorities working together (initially the

US, UK, Canada and Australia – but now including Japan) have set up something called the joint international tax shelter information centre (JITSIC) that focuses on cross border planning . Tax authorities around the world communicate with each other regularly; they share a large amount of information, which they believe is important, to get the entire picture.

It has made the tax auditors more confident that they know more and allow them to engage with businesses better. As long as they don't use information inappropriately, it's a sensible development and I think that corporates' need to understand that tax authorities are speaking with great knowledge with what's going on across the borders. It's not something to be feared it's just something to be recognised and once again it's up to businesses to leverage that dialogue to ask for cross border disputes to be solved more quickly. If the companies want to operate as multinationals, how can they protest at tax authorities that are operating as virtual multinationals. As long as it brings quicker resolution of disputes, then, everyone can succeed.

How do you think taxpayers, the authority and perhaps tax advisors can cooperate and participate towards building better business practices and in your view do you see a way how this can be accomplished?

I gave a speech in the UK, in 2005, to set out five ways that people could collaborate and it was all around the theme of building trusting relationships. You need to be transparent, you need to share, you need to be able to challenge, you need to have a common code and you need to train together so that you realise that you're dealing with the same law – just with a different perspective.

First of all you start with the aim, which is to build trust and mutual respect and then work out what would give that trust and mutual respect. It is important to discuss how businesses operate at both senior and junior levels. To attain good business dialogue you must train people in the tax law and the administration of tax, as much as possible, together. I happen to believe that the enhanced relationship that was set out in the OECD study of tax intermediaries gives some good examples of how you could build that trust.

Despite the loud cry for inclusion of tax in the boardroom discussions and

as a part of corporate reporting, the pace of adoption has been very slow. Do you foresee an improvement in the future?

I do, partly, because there is more pressure. One thing, which I don't like, is if it leads to more unnecessary corporate reporting as I'm concerned that more and more reporting indicates lack of trust.

I recently published an article about how you get the balance between reporting and relationships. My basic theme is that if you have a good relationship you can have less initial reporting because all the detail is available if it is actually needed. If you need lots of information up front, it basically means that you do not trust what you're being told. A balance is important since you can't be naïve but you should minimise the burden and match it to the relationship. If you start with corporate governance principles then you gain faith that the core principles are being applied into practice. If you get the balance between reporting relationships properly it is more likely to work. Do I think the demand for more transparency which may include reporting will increase? Yes, but I would rather if the increase was by cooperation and for the purpose of building insights and relationships than by regulation without a clear purpose or partnership, which is why I think corporates and tax authorities need to get together because if they don't, it will happen by regulation alone which I think, is not good for any government or business.

What advise would you like to leave behind for our boards and revenue authority?

This financial crisis is a point of renewal. It's time to throw away the past and prejudice about the tax system, the way it's being operated and administered. You need to use your collective brains to do what is best for the country and business. At times history will get in the way of the future. If you want to think forward as a country, one of the ways to do is to think about how tax can be administered in partnership and fairly as an instrument to the growth and wealth of the country. Allow the tax base to be broadened and the tax system simplified and with competitive rates. It is not just about policy and rates of tax but it is as much about changed behaviours of tax authorities and taxpayers to work for a broader vision. This will help the wealth of the companies, the wealth of the country and the wellbeing of the people as well.