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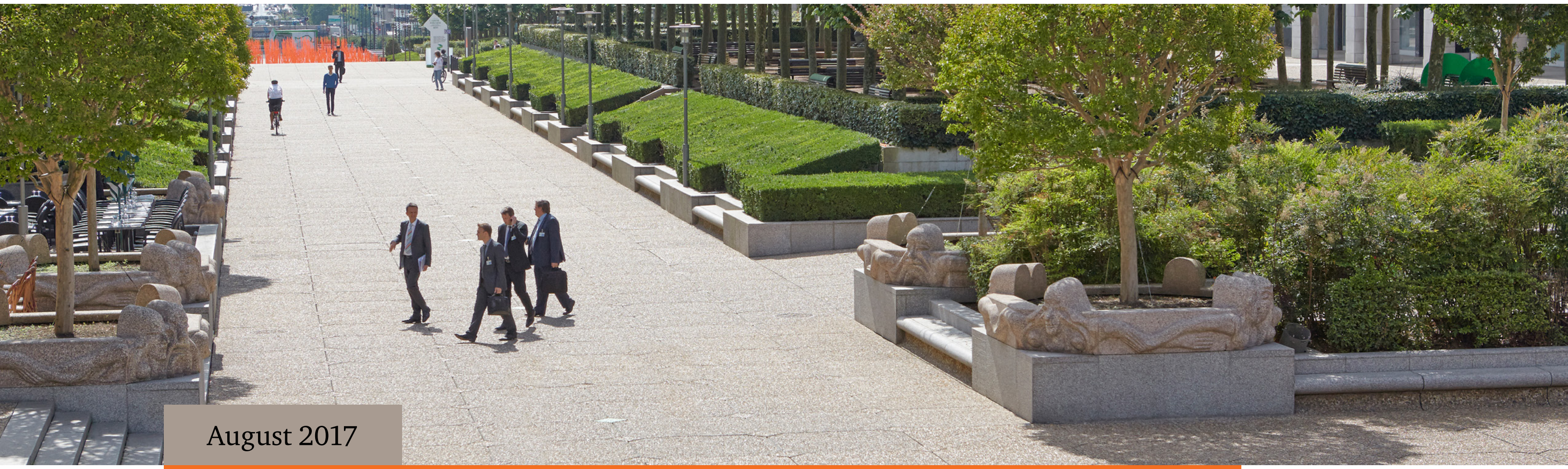

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Overseeing taxes in a new era

Corporate taxes often are a significant expenditure—and the subject of increasing uncertainty, making it a top agenda item for business leaders. How will you rise to the challenge?

Increasing uncertainty, the technical nature and difficult judgments required make tax a challenging area for audit committee members. The frequent lack of deep tax backgrounds can make it even more difficult. But understanding the company's position and risks in the evolving global tax landscape is critical to your oversight role.

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The global corporate tax landscape is complex, and for many companies, reflects a significant business cost. And there are many more risks—including strategic and reputational—than ever before. Media reports scrutinize corporate tax planning strategies, and the public questions whether companies are paying their "fair share" of taxes. Governments, in turn, are looking for ways to increase tax revenues, such as stepping up enforcement to close budget shortfalls. In addition, non-governmental organizations are adding pressure by increasing their investigative efforts of companies' tax strategies.

From a financial reporting perspective, the complexity is amplified by standard setting and regulatory developments in the US and abroad. Income taxes continue to represent a significant portion of comment letters issued by SEC staff. In addition, the FASB and other organizations outside the US continue to propose enhanced disclosures of income tax information, which will likely bring greater scrutiny.

Overseeing corporate taxes is important, and it usually falls to the audit committee, either through its risk oversight role or through its responsibility to oversee financial reporting. Having foundational knowledge to interpret tax information and ask insightful questions is a must-have skill for audit committee members.

Increasing uncertainty: companies are "feeling taxed"

Taxes are often one of the most significant business costs incurred by corporations. At the same time, as many countries and their citizens are being squeezed by fiscal budget issues, they are looking to corporate taxes to help increase their tax revenues. The overwhelming public mood is that everyone—including large corporations—should pay their "fair share" of taxes. As a result, some argue that not only should these large corporations pay more taxes, but that it is their moral obligation as good corporate citizens to do so. There has also been wider recognition that there is a mismatch between tax regimes in different jurisdictions, as they provide various incentives, including tax incentives, to attract capital and business.

This political environment has drawn attention and prompted legislative, regulatory and financial accounting and reporting changes to corporate income taxes in the US and abroad. While some organizations have attempted to provide for uniform changes across jurisdictions, many countries have taken unilateral actions to address perceived loopholes. Often, these unilateral efforts actually result in more, not less, complexity and uncertainty for companies.

Adding to the uncertainty that comes from increased judgment, governments have enacted general anti-avoidance rules and other subjective tests rather than bright-line rules as an approach to address aggressive tax approaches. This makes it much more difficult for companies to assess risk and determine the appropriate financial reporting in connection with tax planning (e.g., the need to establish a reserve for uncertain tax positions and for how much).

The increasing focus and complexity in income tax: a snapshot

Legislative and regulatory changes – Significant changes are on the horizon, including:

- *US tax reform* – A consensus has been building to address perceived tax disadvantages of US businesses. Lowering the corporate tax rate is at the forefront of tax proposals—but there will be trade-offs with varying impact on companies.
- *European Union (EU) Anti-Tax Avoidance Directives (ATAD)* – In mid-2016, the EU voted to pass the ATAD and more recently expanded it through an amendment. Largely inspired by the Organisation for Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting project (BEPS), the ATAD addresses corporations' tax planning strategies that shift income to low- or no-tax jurisdictions. These provisions must be adopted by EU member countries over the next few years.
- *Brexit* – The UK's withdrawal from the EU could have material tax implications for companies. For example, treaties may need to be individually negotiated between the UK and EU member countries to avoid significant withholding tax consequences on basic payments to and from the UK, such as dividends, interest and royalties.

The implications of these changes could be wide-reaching. Beyond tax planning, they could also affect areas such as supply chains, causing companies to consider operational changes.

Aggressive tax enforcement – The European Commission (EC) is investigating corporate tax benefits previously granted by members of the EU that may now be considered "State aid" by the EC. A company that received State aid could be required to repay up to 10 years of those tax benefits, plus interest.

Other jurisdictions across the globe (including individual European countries) are taking aggressive audit approaches, including tax raids and tax assessments, even over relatively small amounts. And tax authorities from different jurisdictions targeting the same company increasingly collaborate by sharing information such as tax opinions and tax rulings with one another.

Increased efforts for transparency – The OECD's Country-by-country reporting proposal (CbCR) would require companies to disclose more financial information by country, and allow the information to be shared with other jurisdictions. The EC's CbCR proposal would even require that all of this information be disclosed publicly.

Other countries have also begun to require enhanced public disclosure. The UK now requires certain companies with UK operations to publish their UK tax strategy on a publicly available website. The required disclosure addresses areas such as risk management and governance, UK tax planning approach, acceptable level of risk and approach towards dealings with the UK taxing authorities.

Focus on financial accounting – Accounting for income taxes continues to draw focus from standard setting and oversight bodies and auditors.

- *FASB* – The FASB issued new guidance impacting the accounting and disclosure for income taxes in the last year. In July 2016, it also proposed enhanced disclosure related to foreign operations, the effective tax rate reconciliation, uncertain tax positions, valuation allowances and government assistance.

- *SEC* – SEC comment letters continue to focus on the effective tax rate reconciliation, valuation allowances, indefinite reinvestment of foreign earnings assertions and uncertain tax positions.
- *External auditors* – Given tax's complexity and the inherent need for management judgments and estimates, the accounting for taxes and the related internal controls are often a significant area of focus of external auditors.

Each of these developments contributes to an evolving landscape that creates a sense of uncertainty and risk that may make oversight challenging.

Understanding the basics: organization of the tax function

Oversight of corporate income taxes begins with the basics: understanding how the tax function is organized globally and to whom the group functionally reports. Tax functions are often faced with competing priorities. These typically include tax accounting for financial statement purposes, compliance and planning. Competing priorities can create talent and skillset challenges and confusion about how to best deploy resources.

Tax functions need to be agile in responding to strategic business changes, such as mergers and acquisitions. Strong forward-looking analysis and planning can be valuable to the company. Some tax functions have been undergoing transformation in many ways similar to the broader finance organizations to enhance internal and external reporting. Many companies co-source certain tax compliance, accounting, or planning activities where there are resource or bandwidth limitations. Others have co-sourced significant portions of the tax function.

It's important for audit committees to understand how the tax function fits into the organization and how it is structured. In addition, it is helpful to know how the function uses third-party resources for specialized knowledge or when resources are insufficient. This foundational knowledge is helpful when considering the various projects and risks the tax group manages.

Diving into taxes

One way audit committees can get a better grasp on the tax function's work is to take a "deep dive" at least once a year. This means allocating time on the agenda for the head of tax to provide an in-depth update as well as an education session on legislative, regulatory and standard setting activity.

What topics could be part of the deep dive?

- Significant tax risks—strategic, operational, reputational—and how they fit into the company's overall risk appetite
- Update on legislative, regulatory, and standard-setting proposals and their possible impact on the company
- Benchmarking of the income tax rate (both the effective tax rate and the cash tax rate) against competitors and peers and assessment of the overall tax burden
- Critical financial statement judgments and estimates, including uncertain tax positions, valuation allowances against deferred tax benefits and management's assertion over its indefinite reinvestment of foreign earnings
- Status of any internal control deficiencies or material weaknesses

- The tax organization, reporting lines and staffing
- Primary advisors and outsource partners and how they are used
- How the tax function collaborates with other groups within the organization to identify tax savings and promote strong internal controls
- Continuous improvement initiatives, such as increased use of data analytics and available technology tools

Audit committees could schedule this session for the same quarter every year and provide an opportunity for updates at subsequent meetings.

Work your relationships

Given the increasing changes and risk, a strong relationship between the audit committee and the company's tax leader can enhance the effectiveness of the committee's oversight. One way to develop this relationship is to periodically include the tax leader in a private session with the audit committee. Even if just once per year, a private meeting can build the relationship and help the committee gain more insights into the tax function and risks in the income tax area. A stronger relationship could enable direct questions about the company's culture. For example, is the head of tax being pressured to take a more aggressive position than preferred? Does he or she have the resources needed to effectively execute the group's workload? Is he or she worried about a particular exposure or position?

Audit committees should also be aware of and monitor key external relationships that could be helpful to their oversight role, including the audit firm and tax advisors.

Meeting the challenge

Tax oversight can seem overwhelming, especially when combined with the audit committee's broader oversight responsibilities. Some key takeaways for fulfilling that role effectively and efficiently include:

✓	***Key performance indicators (KPIs)***	Discuss the KPIs set for the tax function with management and track how the function continuously improves its value to the company. How is the function focusing on analysis versus data gathering and using technology to drive efficiencies?
✓	***Resourcing and reporting structure***	Get an overview of the function's global organization and functional reporting lines. Address how these global resources sufficiently address tax planning, tax compliance and tax accounting for financial statement purposes.
✓	***Risk assessment and risk appetite***	Understand how the tax function's risk assessment—strategic, operational and reputational—is aligned with the rest of the organization's philosophy and risk appetite.
✓	***Significant judgments and estimates critical to the accounting and disclosures in the financial statements***	Have management provide an overview of the highly subjective areas. This typically includes the reserve for uncertain tax positions, valuation allowances and management's assertion over its indefinite reinvestment of foreign earnings (often referred to as the "APB 23 assertion").
✓	***Legislative, regulatory and standard-setting changes***	Use the "deep dive" meetings as an education session to better understand the global tax environment and how changes could impact the company.
✓	***Interaction with other company functions***	Understand how the tax function interacts with business units, finance, treasury, and compliance to address tax opportunities and risks. How do they ensure their efforts are aligned?
✓	***Tax leader relationship***	Meet in a private session at least annually to maintain a relationship with the tax leader to enhance communication and gain more insights.
✓	***Use of third-party partners and advisors***	Understand how management evaluates the use of third parties as co-sourcing or outsourcing partners or advisors to increase effectiveness and efficiency. Consider direct discussions with third parties, including the external auditors, to get multiple points of view on the risks and opportunities.

How PwC can help

To have a deeper discussion about how this topic might impact your business, please contact your engagement partner or a member of PwC's Governance Insights Center.

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- *To GAAP or non-GAAP? The SEC is watching*
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