Three key levers to build trust with stakeholders

In today's increasingly complex business environment, establishing trust in the tax system has become a strategic imperative for long-term growth. This article looks at the benefits of promoting tax transparency and tax-related disclosures to strengthen stakeholder relationships.

The trust imperative

Business leaders face a multitude of challenges in today's fractured world. There is a growing demand for openness and clear communication, with stakeholders seeking heightened transparency from businesses. Investors, regulators and employees today are eager to know not only about functional and operational aspects of businesses but also about the steps being taken to be compliant with the regulations and give back to society – whether it is in terms of the sustainable practices they follow or the taxes they pay.

In a 2023 PwC survey, over 70% of respondents believed that shareholders and regulators were interested in the tax transparency practices of a company, while 50% felt that employees took note of their company's actions.[1] Another study found that 64% of investors chose to invest in a company that was aligned with their beliefs and values.[2] Interestingly, PwC's Global Investor Survey 2023 had outlined that investors were grappling with a deepening trust deficit. It found that investors gathered information from a range of sources, including companies and third parties, to make investment decisions, rather than depending on a single source of truth.[3]

1 PwC, Tax transparency in ESG, Jan 2024

2 https://www.edelman.com/trust/2022-trust-barometer

3 PwC's Global Investor Survey 2023

With an increase in the societal responsibility of businesses, trust is becoming harder to earn. Of late, there have been renewed discussions on tax morale – the willingness to pay tax. A 2022 Organisation for Economic Co-operation and Development (OECD) report[4] highlighted the need to build trust between taxpayers and tax administrations and boost the tax morale of multinational enterprises (MNEs). Tax morale in MNEs assumes particular significance in the context of developing countries that are more likely to rely on corporation tax for domestic resource mobilisation compared to developed countries.[5]

At a global level too, there is an acknowledgement of the fact that tax trust has been eroded amidst growing societal divides and that tax morale needs a boost.[6] In the same vein, at the 2024 World Economic Forum at Davos that brought together leaders from 120 countries, there was a laser focus on the theme of 'rebuilding trust'.

With earning trust gradually becoming a principal driver alongside increasing societal responsibility, tax has taken centre stage. It is a crucial indicator of how a business perceives its role in society.[7] In developing countries, taxes are an important source of government revenue. In India, taxes collected at the federal level have been averaging about 11% of the GDP[8] over the last few years. Companies, however, highlight only their corporate social responsibility (CSR) spends – that account for roughly 2% of a company's profits – and the resultant socio-economic impact while ignoring the contribution they make by way of taxes, which could be as high as 15% to 20% of their turnover. This contribution funds public infrastructure, the country's commitment to sustainable development goals (SDGs) and climate action, and in turn supports a well-oiled economy.

Tax then is a lifeline, while tax transparency and proactive disclosure of tax positions are condiments to foster greater customer stickiness, build a foundation of trust and credibility, help businesses gain a competitive advantage and, most importantly, demonstrate the role companies play in contributing to the government coffers. This can pave the way for building trust and responsible tax practices that are difficult to achieve through tax policies and policing alone.

Three levers that can propel businesses to build trust with their stakeholders are:

- **Tax transparency**
- **Tax-related disclosures**
- **Tax certainty**

While the onus of driving tax transparency and tax-related disclosures is on businesses, the responsibility to ensure tax certainty lies equally with the regulators.

Tax transparency

Tax transparency can help investors understand if reduced tax payments or operating profits are the sources of a company's cash flow. Non-payment of undisputed tax and withholding tax, and non-payment of social security contributions can serve as an early warning that a business may not be meeting its obligations. Countries such as Australia and the UK have developed frameworks for tax transparency disclosures. The European Union, too, requires multinational companies with a presence in more than one country to publish the amount of taxes paid in each country.[9] But as tax transparency reports are a voluntary disclosure in India, there is a significant gap in tax transparency reporting among companies in the country:[10]

- 75% of companies in a PwC survey did not have a publishable tax transparency report.[11]
- Only 23% of companies said they use Global Reporting Initiative (GRI) 207/other standardised tax reporting practices.[12]

4 OECD (2022), Tax Morale II: Building Trust between Tax Administrations and Large Businesses, OECD Publishing, Paris, https://doi.org/10.1787/7587f25c-en.

5 Ibid.

6 World Economic Forum, Annual Meeting 2024

7 PwC, Building public trust through tax reporting, March 2023

8 PIB, Estimates of national income, 2023-24

9 https://www.thehindubusinessline.com/business-laws/why-tax-transparency-report-enhances-value/article36302051.ece

10 PwC, Tax transparency in ESG, January 2024

11 Ibid.

12 Ibid.

While policy interventions are required to bridge this gap, some companies in India have begun to voluntarily make public disclosures concerning key tax aspects. They are doing so by publishing their tax metrics, approaches, and tax risk management and control frameworks through tax transparency reports (TTRs). This is a step in the right direction and an opportunity to build positive narratives, a fact corroborated by the 2023 PwC survey wherein 47% of the respondents said that tax transparency disclosures could improve a company's standing by portraying it as engaging in responsible tax behaviour and 34% agreed that tax transparency is an opportunity to deliver a positive story.[13]

On the flip side, companies may face public criticism when their tax practices are not transparent or seen as unfair. An American company in the UK suffered customer boycotts and a sales drop after it was perceived as not paying fair taxes. Being transparent when it comes to tax can help companies avoid the perception that they may be engaging in unethical practices. A study of over 30 pharmaceutical companies in India found that they have paid, on average, an effective income tax rate ranging from 7.5% to 29% over five years.[14] In the absence of transparency in tax matters, outlier companies may feel the need to provide a satisfactory explanation as to why they fall outside of this range, or risk being perceived as unethical. In the absence of adequate disclosures, a company being consistently free of tax disputes, contrary to the industry trend, may be construed as indicative of wrongdoing. This may be the case even when the company is managing its disputes through advance ruling or advance pricing arrangements. Voluntary disclosure as a means of providing a narrative to establish the minimum tax requirement (say 15%) for certain service and equipment providers in the oil and gas sector who pay 4.2% tax on their gross revenue under a special dispensation is important so that they are not seen as underpaying taxes.

When companies implement tax transparency-linked key performance indicators (KPIs), they are seen as following responsible practices. Moreover, rating agencies' perspective on tax is maturing and it is being recognised as a material factor in evaluations. But in various sectors, the weightage given to tax metrics is either zero or too low. Often taxes are chosen as a material topic for disclosure by companies for reporting voluntarily despite rating agencies giving a low rating or no weightage. Meanwhile, rating agencies seek tax information and many companies score zero in the assessment of their tax matters.

For most businesses in India, a major hindrance to tax transparency reporting is that it increases compliance costs as more data needs to be collated.[15] This is where a technology-driven approach can turn tax transparency from a matter of compliance to a strategic advantage.[16] In fact, spurred by demands of regulators on aspects of transparency, speed and participation in the tax base, tax transparency has become a key driver for digital transformation strategies in organisations. Not just in India, governments across the world are pushing for major digital changes such as faceless assessments, digital compliance and e-invoicing to enable a connected view of a taxpayer's profile as well as holistic tax assessment.

Tax-related disclosures

Tax disclosures – earlier aimed mainly at investors – now need to speak to a larger audience and go beyond reporting the effective rate of corporate income tax.[17] Since tax-related data is measurable and lends itself to analysis and comparison, transparent disclosure of key tax metrics not only enhances the credibility of the company, but also validates its broader commitment to ESG values.

At a global level, countries are benefiting from implementing tax transparency and exchange of information (EOI) standards. The global meltdown of 2008 and consequent need to augment domestic resources led to countries agreeing to develop efficient information exchange mechanisms with a view to prevent tax base erosion. The Multilateral Convention on Mutual Administrative Assistance and Information Exchange (2012) developed by the OECD and propagated by the Global Forum required countries to provide tax-related information without taking recourse to bank secrecy or any other country practice that allowed opacity.

13 Ibid.

14 PwC analysis

15 https://www.thehindubusinessline.com/business-laws/why-tax-transparency-report-enhances-value/article36302051.ece

16 PwC, Technology and tax transparency

17 PwC, Building public trust through tax reporting, March 2023

Corresponding changes were agreed to in the OECD Model Convention as well as in the UN Model Convention to strengthen the Article on exchange of information. A new instrument termed as a limited-purpose bilateral Tax Information Exchange Agreement was devised to help countries to reach out to jurisdictions with whom they did not wish to have a comprehensive tax treaty.

Automatic exchange of financial accounts information was successfully implemented globally through the Foreign Accounts Tax Compliance Act (FATCA) of the United States and the Common Reporting Standard (CRS) devised by the OECD. India was a major supporter, participant and early adopter of all these initiatives and now has a formal exchange of information relationship with about 135 countries. A large number of developing countries, including offshore financial centres and small island states are active participants in this information explosion, with very good outcomes in terms of domestic revenue mobilisation.

Since 2009, Asian members of the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum) have identified at least EUR 20.1 billion in additional revenue – tax, interest and penalties – owing to exchange of information on request (EOIR) and automatic exchange of financial account information (AEOI), including voluntary disclosure programmes and offshore tax investigations.[18]

While these efforts were aimed at facilitating cooperation among tax authorities, the G20/OECD Base Erosion and Profit Shifting (BEPS) project introduced country-by-country reporting (CbCR) in 2015 by multinational corporations to tackle issues related to tax avoidance and profit-shifting. Nearly 100 countries are currently implementing the CbCR, which is one of the minimum standards agreed to by countries in the BEPS project and requires MNEs to disclose the amount of revenue, profit before income tax, and income tax paid and accrued for each jurisdiction in which they operate.[19] They also need to provide details on their stated capital, tangible assets, number of employees and retained earnings in each tax jurisdiction.[20]

Further, Action 12 of the BEPS project provided guidance on mandatory disclosure rules under which the existence of certain hallmarks in an arrangement or transaction would require prior disclosure to tax authorities. Mandatory disclosures are meant to provide tax administration advance information on potentially abusive or aggressive tax planning schemes and to identify users of such schemes. Taxpayers, too, would be wary of entering into certain schemes if they need to be disclosed.[21]

Countries like the United Kingdom, Canada, the United States and Portugal already follow disclosure regimes for identification of tax planning, avoidance and tax abusive schemes.[22] India may also do so in the near future. These regimes are expected to not only help either side in reviewing and preparing for the schemes sought to be implemented but also foster greater mutual understanding and trust between taxpayers and tax administrations.

18 https://www.oecd.org/tax/transparency/documents/tax-transparency-in-asia-2023.htm

19 OECD (2015), Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/9789264241480-en.

20 Ibid.

21 OECD (2015), Mandatory Disclosure Rules, Action 12 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/9789264241442-en.

22 https://www.moneycontrol.com/news/trends/features/does-india-need-mandatory-disclosure-rules-1429361.html

Moreover, with the emergence of new and highly digitalised business models, countries are seeking more coordinated and uniform measures to enhance transparency. For instance, the OECD along with G20 countries has developed the Crypto Asset Reporting Framework, a dedicated global tax transparency framework which provides for the automatic exchange of tax information on transactions in crypto assets.[23]

Tax certainty

Businesses attach great importance to tax certainty and reducing disputes. Thus, enhanced tax transparency and increasing disclosure requirements must be accompanied by concrete measures to enhance tax certainty. Tax certainty is a key focus area of tax administrations to ensure dispute avoidance as well as resolution of disputes, be it in direct taxes or in indirect taxes. This is reflected in the OECD declaring 14 November as Tax Certainty Day to emphasise the necessity of tax certainty for all stakeholders.

When it comes to direct taxes, India has made substantial progress through Alternate Dispute Resolution mechanisms. But in case of indirect taxes, especially the Goods and Services Tax (GST) which was rolled out in 2017, there is a larger scope for improvement in tax certainty, both in terms of statutory as well as administrative measures. In the present GST landscape, a large number of notices have been served by the Central and State Tax authorities to taxpayers across the country, especially to beat the extended limitation period for the years 2017–18 and 2018–19 for non-fraud cases. A substantial number of these notices were generated through data analytics and automated processes triggered by mismatches beyond a particular threshold that were detected in the GST returns filed by the taxpayers. These notices have led to numerous disputes which have added to the existing heavy litigation burden on taxpayers.

Advance Rulings are an important tool for building trust with taxpayers by imparting both stability and certainty in their tax positions. However, such dispute avoidance mechanisms in GST have not led to the desired levels of tax certainty. One of the main drawbacks is the lack of a centralised Appellate Authority for Advance Rulings (AAARs) which can resolve the often contradictory or conflicting Advance Rulings in different states on the same issue. The GST Council had acknowledged that the Authorities for Advance Ruling (AARs) in different states were giving conflicting decisions on similar issues involving similar facts, causing confusion among tax officials and taxpayers. It had given an in-principle nod to set up the umbrella body in December 2018,[24] but the recommendations are yet to be implemented.

Furthermore, the dispute resolution process in GST is currently rather truncated and delayed as the establishment of the GST Appellate Tribunals (GSTAT) is still some time away. Under the GST framework, Appellate Tribunals are meant to hear appeals against the orders passed by the Appellate Authority under the Central and State GST laws.[25] Currently, taxpayers are often forced to approach the High Courts in cases where the authorities try to recover the disputed amount even before the taxpayer has exhausted the appellate remedy at the tribunal level. The number of appeals under central GST laws alone in High Courts stood at about 15,000 in October 2023.[26] The urgency and necessity to operationalise the GSTAT cannot be overemphasised in the context of certainty in the dispute resolution process. The government has said that Appellate Tribunals are likely to begin operations around July or August 2024.[27]

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Simultaneous or parallel investigations by different GST authorities on the same taxpayer for the same issue is a burning problem that results in avoidable tax uncertainty, business disruptions and a huge compliance burden on the taxpayer. This needs urgent attention of the GST Council as streamlining the investigation process will lead to greater trust and enhanced compliance.

While there is much to be expected from the tax administration for ensuring timely and effective resolution of tax disputes, particularly in respect of GST, businesses must also gear up and make conscious efforts towards minimising tax litigation, including:

a. streamlining their compliance processes and making them more aligned with expectations of policymakers

b. engaging constructively with regulators and the tax administration through processes like cooperative compliance, thus helping to create an environment of trust and transparency that would be mutually beneficial.

Transparent disclosures on tax management lend a credible standing with regulators for advocacy, while customers also require tax profile-related data and information as a part of their vendor approval process. Moreover, sourcing talent becomes easier when employees are aware of their company's responsible tax behaviour and get to experience it first-hand. Therefore, the benefits of tax transparency for businesses include:

- better credibility and enhanced trust
- increased investor and employees' confidence
- improved governance and risk management in tax matters.

This is also corroborated by PwC's Tax transparency in ESG 2023 survey results,[28] which show that businesses have already started to recognise that sustainable business practices and responsible tax behaviour are required to drive sustainable economic growth, leading more companies to make voluntary disclosure on tax matters. Voluntary disclosures could help businesses demonstrate accountability, while tax certainty can provide them with a better understanding of their obligations. Together, tax transparency, disclosures and tax certainty can lay the groundwork to build trust with stakeholders.

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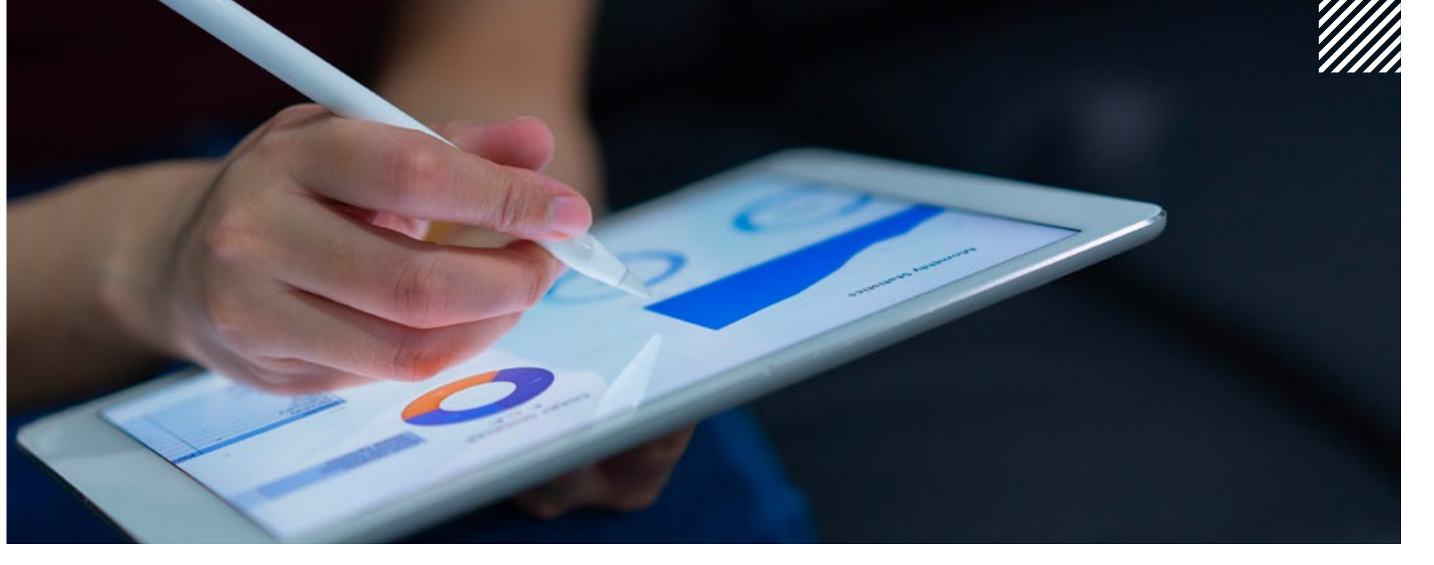

23 OECD (2022), Crypto-Asset Reporting Framework and Amendments to the Common Reporting Standard, OECD, Paris, https://www.oecd.org/tax/exchange-of-tax-information/crypto-asset-reporting-framework-and-amendments-to-the-common-reporting-standard.htm

24 Thirty-first GST Council Meeting, December 2018

25 GST Appellate Tribunals

26 Ibid.

27 Ibid.

28 PwC, Tax transparency in ESG, January 2024