# Tax Transparency in Corporate Reporting: User Perspective

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## Introduction

Tax revenues are important for the effective management of government and society such as the funding of governments' service delivery and developmental agenda to sustain the healthy functioning of its society. [12], [14], [16] Therefore, when companies shirk their responsibility- be it tax avoidance to outright tax evasion- there are tangible social, environmental and economic consequences for society, including exacerbating inequality amongst its citizens. [12], [14]

Tax has often been viewed by many as activities limited to managing compliance and minimising cost. However, the linkage between paying taxes and corporate responsibility has propelled the discussion of taxes into the public domain. Investors are uneasy about companies' increasing tax-aggressive behaviour and the subsequent consequences of such behaviour, for instance brand or product bans; potential litigation; and reputation erosion; as civil society questions this conduct. Luxleaks, Swissleaks, the Panama Papers and the Bahama Papers and other corporate misbehaviour have fuelled the growing trust deficit amongst stakeholders. [17], [18]

Tax transparency relates to the availability of company tax- related information to stakeholders, [12] and supports reducing tax avoidance activities by contributing to the visibility of companies' tax payments, calculations, disclosure, etc. [18] Locally and globally there are a number of initiatives that promote enhanced tax transparency, as depicted in Figure 1, below.

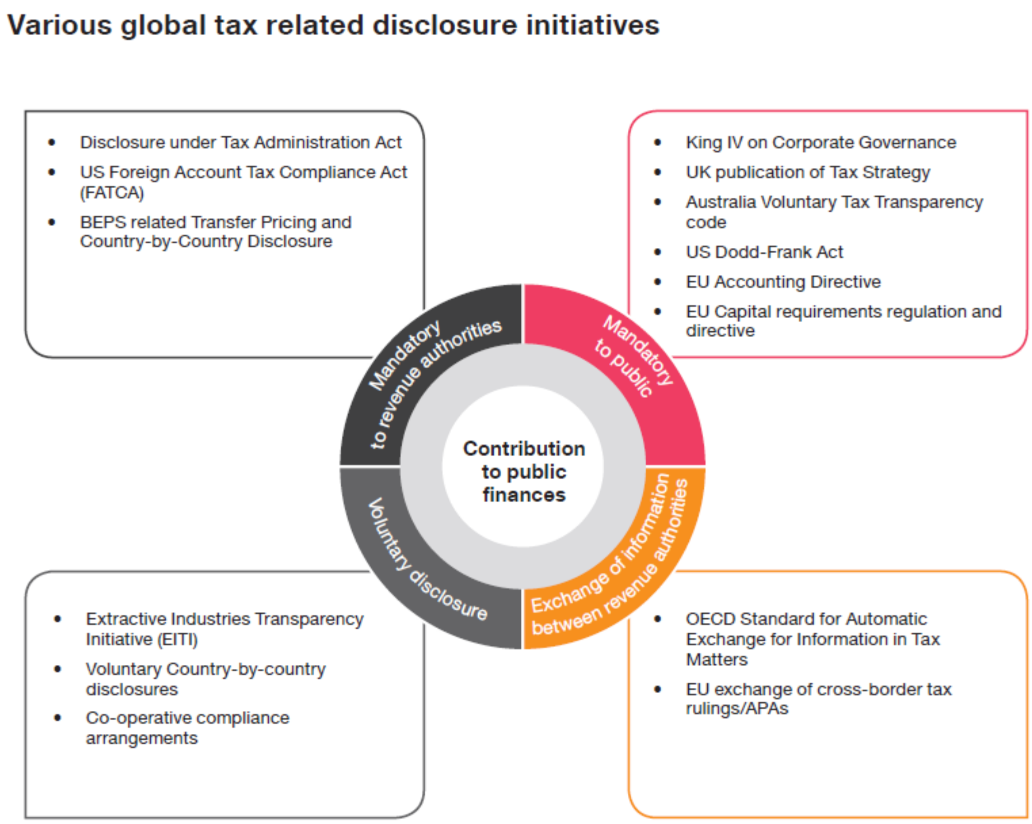


*Figure 1: Various global tax related disclosure initiatives [16:4]*

In addition to the above, stakeholders can access companies' tax disclosures from a variety of reports within the corporate reporting suite such as the annual financial statements, integrated reports, governance reports, sustainability reports, etc.

The discussion that follows outlines the importance of tax transparency; and explores tax disclosures in relation to reporting frameworks, trends and user views.

## Tax Transparency Imperative

Many people would argue that the primary reason for a company's existence would be to maximise profits, thus minimising the tax liability is in support of this business need. However, there is an erosion of stakeholder trust as increasingly the perception is that companies are actively avoiding or evading paying the tax that is owed in the regions where they operate, especially in developing countries. [16] As highlighted earlier, companies participating in such behaviour become vulnerable to a number of potential risks. Developing countries suffer the consequences of tax avoidance more intensely as funds that would have been available for use to further the developmental agenda, is now secured in a tax haven. [14]

A company's purpose goes beyond the profit- driven motive- "The purpose of a company extends beyond creating value for shareholders. It includes the company's role in society, and the contribution it makes to the economy and to the lives of employees, customers and communities where it is located." [16]

King IV [8] advocates stakeholder- centricity, corporate citizenship and sustainable development, challenging companies to recognise that they are no longer islands operating in a vacuum but rather a component of a larger interconnected system. Therefore, companies must balance effective tax management - paying the tax that they are obligated to pay -with the profit objective, thereby demonstrating accountability and transparency to stakeholders.

The more transparent a company is, the less likely it is to engage in tax avoidance practices. [12]

## Reporting Frameworks' Requirements

Effective corporate reporting supports transparency and accountability, which results in fostering an environment of trust between a company and its stakeholders. [16], [19]

There are a number of reporting frameworks that organisations apply to communicate with their various stakeholders. For the purposes of this paper, only the International Integrated Reporting Council's (IIRC) Integrated Reporting Framework (IRF) and the Global Reporting Initiative's (GRI) Standards are discussed.

## Integrated Reports

Before exploring the tax- specific reporting requirements, it is useful to appreciate the influence of the King Corporate Codes of Conduct in shaping how South African organisations approach corporate reporting, particularly integrated reports.

The King Code of Corporate Governance (King III) [7] was South Africa's first introduction to the concept of an integrated report. King III becoming a JSE listing requirement was the catalyst for companies accepting integrated reports as part of the corporate reporting suite.

King IV [8] emphasises the concepts of integrated reports, value creation, corporate citizenship, sustainability, and stakeholder- centricity. It advocates that all organisations (regardless of sector or size) be ethical and demonstrate good corporate citizenship. These underpinning themes are reasonably aligned with the objectives of the IRF.

One of the key aims of the IRF relates to improving "accountability and stewardship" [9:2] of the capitals. The capitals are categorised as financial, manufactured, intellectual, human, social & relationship and natural. [9:11] Keeping this aim and that tax is a corporate responsibility in mind, it is expected that where appropriate, a company's tax disclosure is featured within the discussions of the various capitals and not only limited to disclosures related to financial capital. The IRF does not explicitly give direction on this topic and only mentions taxation as an example of a possible outcome. [9]

It is implied as with any other topic that how tax disclosures are reported on, is dependent on a company's consideration of materiality, stakeholder expectations, risk responses, strategy execution, impact of activities, balancing of trade- offs, etc. Regardless of how complicated this may seem, the IRF presents companies with the opportunity to think in an integrated manner so as to foster tax transparency, trust and accountability with stakeholders. [15]

## Sustainability Reports

The GRI's guidance continues to be the most widely used sustainability reporting framework. [10] Currently, the GRI is updating the tax standard which is expected to be released in December 2019. The GRI suggests that transparency is a means with which to demonstrate that companies are good corporate citizens, i.e., paying their fair share of tax and using tax strategies that support this objective. Therefore, the goal of the update is to improve the level of transparency, and accountability related to company tax through enhanced disclosure. [3]

The tax standard exposure draft outlines disclosure guidance covering the following aspects as seen in the figure below:

*Figure 2: Extract from GRI Exposure Draft* [2:7]

A common purpose of most reporting frameworks is enhanced and transparent disclosure of the organisation and its impacts. Although many reporting frameworks do provide suggestions or principles for better quality communication with stakeholders, the challenge for companies is in the real- world application of the furnished guidance and principles to realise effective communication.

## Current Trends

Globally, there is continued growth in the usage of integrated and sustainability reports as channels to communicate corporate responsibility. [10] In all likelihood, this trend is set to continue, and various iterations of these frameworks will impact how and on what companies communicate to their stakeholders. Further to this is the increasing number of new reporting frameworks and initiatives that require companies to expend resources to present similar information using multiple different formats.

Rising pressure from civil society and investors calling for improved tax transparency has seen worldwide, an increased level of disclosure beyond mere compliance (95% of companies), from 9% (2014) to 47% (2018) in only a four- year period. Aspects covered by companies include: "compliance with the spirit of the law; company's approach to transfer pricing; use of tax structures intended for tax avoidance; commitment not to transfer value created; and use of 'tax havens'". [14:7]

There is a shift by the investor community towards responsible investment with the emphasis primarily on environmental, social and governance aspects. Tax, which has a direct impact on these aspects be it from a corporate responsibility perspective or a government developmental agenda, is now being included as part of the responsible investment assessments. [18] The Dow Jones Sustainability Index is an example of where taxation is incorporated into the evaluation. [11]

Additionally in South Africa there is increasing disclosure by companies on: "tax position; tax strategy; tax risk management; tax numbers; key performance indicators; economic contributions (taxes and other regulatory levies payable to the government, investment in infrastructure, employment opportunities and social upliftment) per jurisdiction; value creation; and internal tax governance processes."[16:5]

A study has found that 50% of the companies evaluated in relation to their transparency of the tax reporting, required improvement. This study also indicated that at that point in time, there were gaps in the tax disclosures by South African companies and they also needed to consider "international best practice". [15:21]

## User challenges & consequences

Although a number of companies are responding positively to calls for greater tax transparency, concerns related to tax disclosures have been identified such as: [5], [6], [13]

- Information is presented in a convoluted manner.
- Only the bare minimum information requirements are met.
- Or conversely, an inordinate amount of information is furnished.
- The language used is too technical i.e., steeped in tax and/ or accounting jargon.
- Disclosures contain inadequate pertinent information.
- Information is presented in a manner that does not support effective communication.
- Too much unrelated or immaterial information is presented.

All of the above influence how stakeholders engage with the tax disclosures, i.e., is the information readable, understandable or useful to facilitate effectual decision- making.

Disclosures to users are limited in its usefulness if these disclosures:

- Confuse users
- Are not understandable
- Are open to misinterpretation
- Require an unreasonable amount of time to work through
- Have missing information

This in turn has potential consequences for the company, for instance causing investors to provide capital at a considerable cost to the company; to disinvest or to not invest in the company. [5], [6]

It is essential that companies understand who the users of the tax- related information are in terms of user requirements and skills levels to promote effectual communication. For example, investors require information for investment decisions and they usually use footnotes or management assertions as an information source. Some users may have insufficient skills and/ or experience with interpreting tax disclosures; or may feel overwhelmed due to their limited knowledge and may draw incorrect conclusions. [1]

Stakeholder expectations of tax disclosures is still an area requiring further study as little information is available. What has been identified is that it may not be about further transparency, but rather about context- setting, i.e., explaining to stakeholders in an understandable way about: why those decisions or why that strategy. [13]

# SAICA Survey

Thus, SAICA decided to undertake a high- level survey to determine the: purpose; usefulness; and deficiencies of current tax disclosures in companies' corporate reporting.

The discussion of the results that follow should be considered anecdotal in nature, and should neither infer causality nor conclude on strong positive or negative relationships.

## Respondents classification

There were 13 valid responses to the questions posed, of which six were tax practitioners. The other seven respondents were categorised as users of the tax disclosures, whilst the tax practitioners were better suited to be categorised as preparers of the information. The non- tax practitioner group, comprised financial managers, auditors and an academic. Thus it was assumed that all had a reasonable understanding of accounting and tax.

## Discussion

### Reliance & purpose of tax disclosures

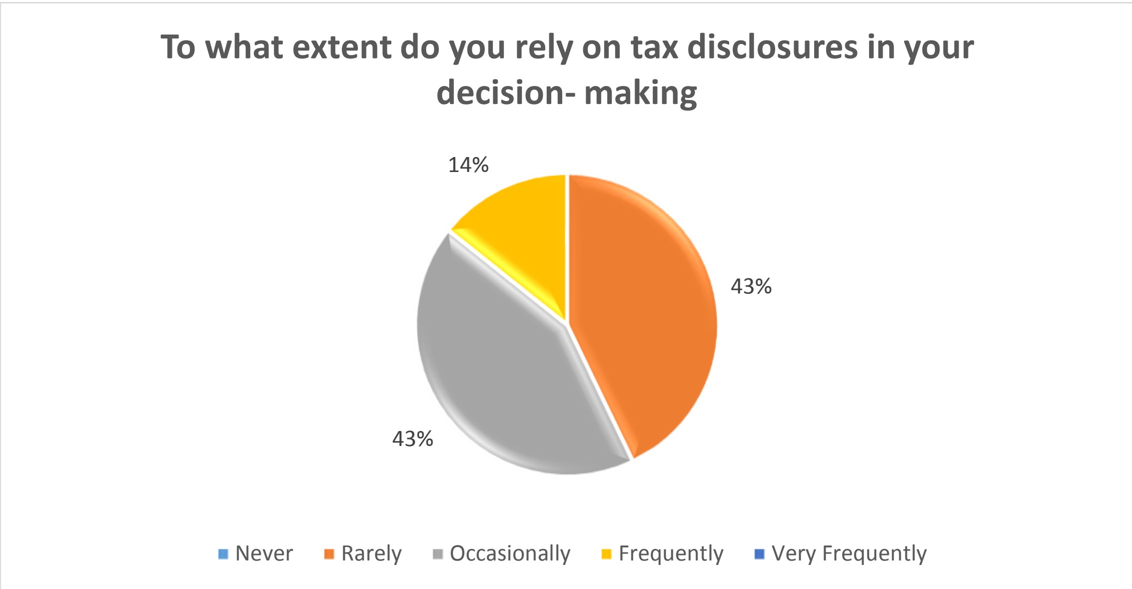


*Figure 3: Responses from non- tax practitioners*

All respondents make use of tax disclosures in their decision- making, though to varying degrees. This collective affirmative response is an encouraging indicator that tax disclosures are deemed necessary. 33% Of tax practitioners indicated their reliance as 'very frequently' and only 17% as 'rarely'.

Non- tax practitioners included some of the following reasons as to why they use tax disclosures: compliance to legislation; assessed loss; tax reconciliation; deferred tax and tax rates. Tax practitioners stated that their usage is related mainly to determining tax payments; tax planning; and calculating effective tax rates.

## Sources of tax information

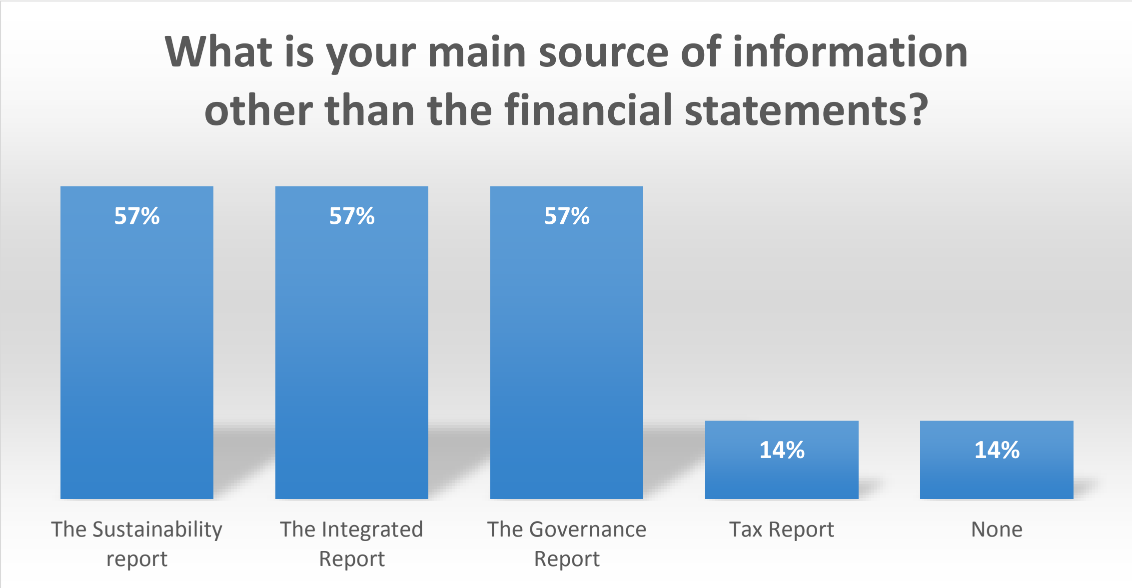


*Figure 4: Responses from non- tax practitioners*

It is interesting to note that only 14% of respondents rely solely on the financial statements as their primary source of information. 14% Referenced all four report-types - the sustainability report, the integrated report, the governance report and the tax report – as their information sources. Another 43% indicated that in conjunction with the financial statements, they drew information from either the integrated or sustainability or tax report. All other respondents utilised a combination of the above report- types as sources of tax disclosures, i.e., relied on more than one source for their information requirements.

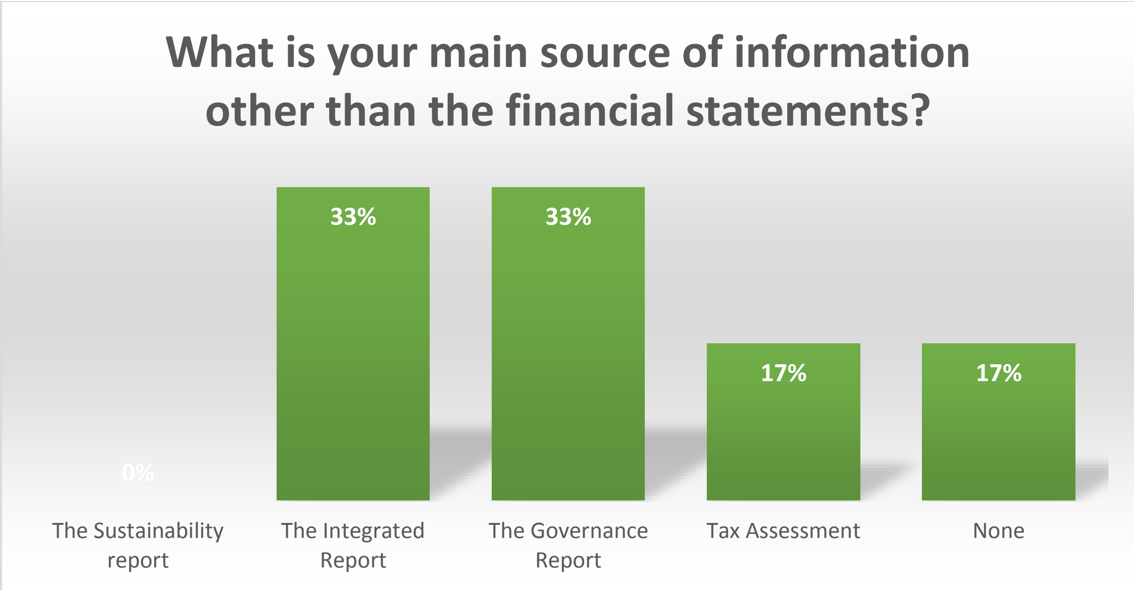


*Figure 5: Responses from tax practitioners*

Tax practitioners rely mainly on only one source for their information requirements (other than the financial statements), i.e., either the integrated or governance report. These respondents do not access sustainability reports as a source of information for tax disclosures. It is interesting to also note the difference in approach in sourcing information between non- tax practitioners and tax practitioners. Non- tax practitioners utilised a combination of the above report- types as sources of tax disclosures, whilst tax practitioners accessed only a single report- type.

It may be that the non- tax practitioners are drawing upon multiple sources of tax information to minimise risks associated with clarity, consistency and accuracy of the information, or to maybe formulate a more holistic view of the tax disclosures of a company to support their decision- making.

## Characteristics of & improvements on tax disclosures

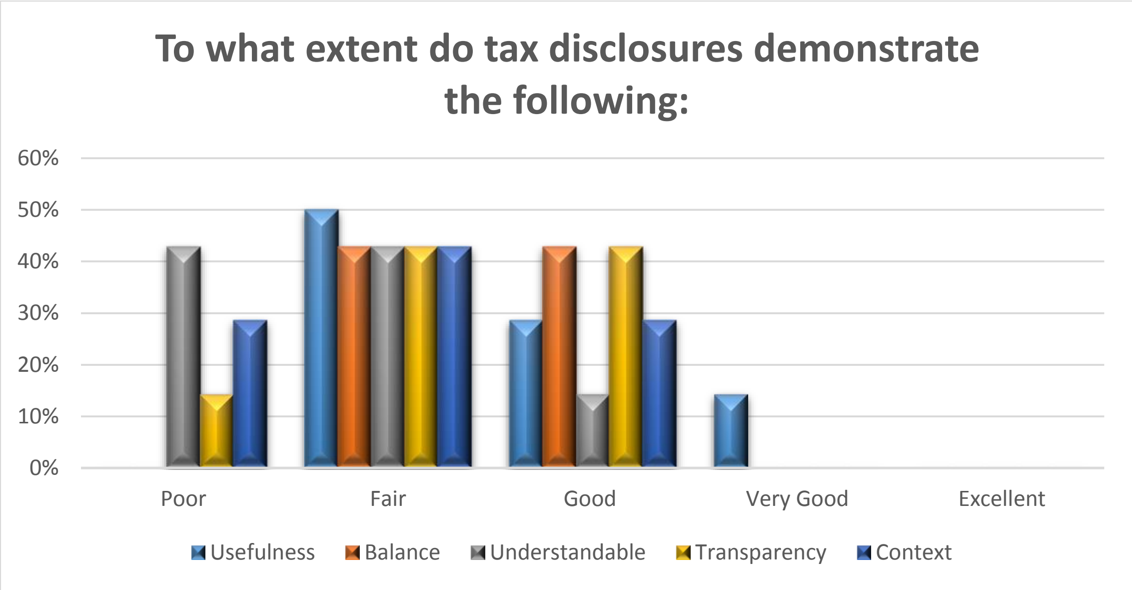


*Figure 6: Responses from non- tax practitioners*

Respondents indicate that they do find the disclosures useful, however in general there is room for improvement for tax disclosures to better demonstrate these characteristics. It appears that considerable work is required in improving these tax disclosure characteristics: transparency; understandable; and context. Respondents suggested the following areas requiring improvement: more transparency; simplicity; providing context to numbers; and more detail on for example tax strategies, tax liabilities and total tax burdens.

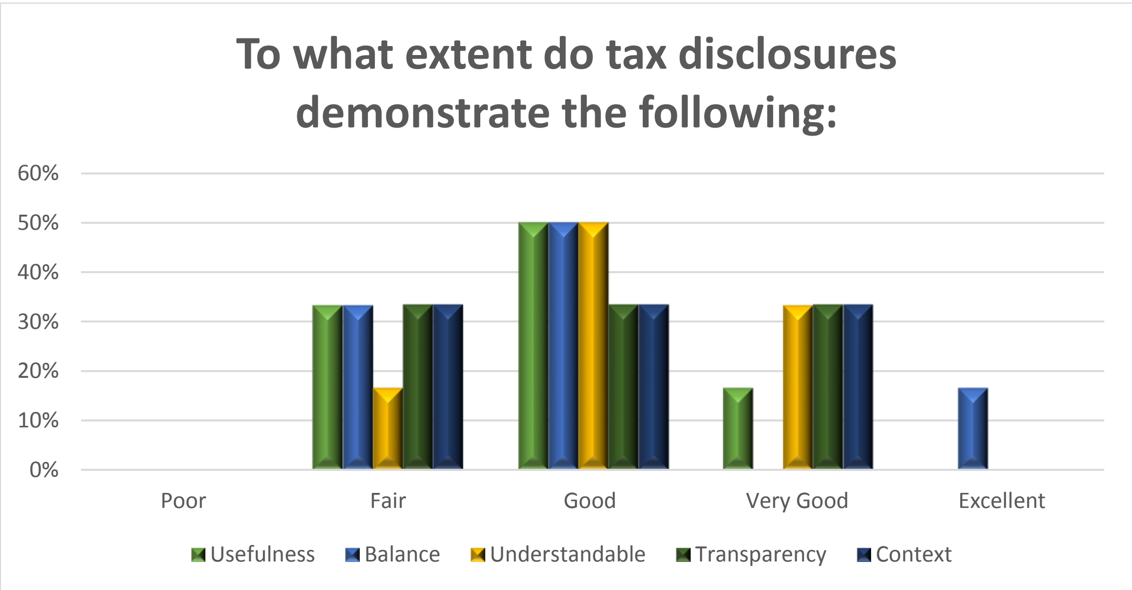


*Figure 7: Responses from tax practitioners*

The tax practitioners' views suggest that some improvement is required in relation to these characteristics, though not to the extent to which the non- practitioners' group appear to suggest. This group suggested the following improvement areas for companies: the tax calculations; penalties payable; include the applicable tax laws per jurisdiction; and more comprehensive disclosure in general.

It appears that preparers are relatively comfortable that the information needs of the users are being met, whilst the users are indicating that this may not necessarily be the case. Some non- tax practitioners rated the characteristics: understandable, transparency and context as poor, whereas none of the tax practitioners rated any of the characteristics as poor. 17% Of tax practitioners rated the characteristic 'balance' as excellent, whereas none of the non- tax practitioners rated any of the characteristics as excellent. Overall, the non- tax practitioners rated the characteristics mainly in the fair to good categories, whilst the tax practitioners were more optimistic as they ranked the characteristics mainly in the good to excellent categories.

# Future Work

As previously highlighted, the survey was deliberately designed to be high- level, and with that there are some inherent limitations. Further limitations were as a result of a small number of responses as well as the homogeneity of the respondents. Any future work whereupon conclusions are to be surmised, will require a much larger response rate as well as a greater respondent or user diversity.

Based on the research undertaken and the insights gathered from the responses to the survey questions, the following are suggested as areas of future research or work:

1) Guidance on how to navigate the various reporting frameworks and/ or initiatives, or preferably a shift towards framework consolidation to streamline the reporting of similar tax information.
2) What does 'good' tax disclosures from a user's point of view look like in an integrated and/ or sustainability report?
3) Identify the motivation and value behind accessing multiple information sources by non- tax practitioners to elicit tax information. And, to translate these learnings to benefit tax practitioners.
4) From a user of tax disclosures perspective, identify:
    a. Relevant characteristics of tax disclosures, including defining each, e.g., transparency comprises "clarity, accuracy and disclosure" [13]
    b. What is the limit at which these characteristics change from a being positive attribute to a negative one, e.g., how much of tax disclosure detail is too much before the value of transparency is lost [13]
    c. How can these be improved within the context of the existing reporting frameworks such as the IRF.
5) What is the user view on transparency of tax disclosures when perusing a company's compliance to existing tax- specific frameworks/ legislation/ regulation/ initiatives? Are these frameworks/ legislation/ regulation/ initiatives meeting the information needs of the user?

# Conclusion

Tax reporting has moved beyond mere financial disclosure into the arena of corporate responsibility. Investors and civil society are taking notice of how companies manage and disclose their tax obligations and there are severe consequences for what is deemed to be 'bad' behaviour on the part of companies.

Effective corporate reporting enables an environment of trust between a company and its stakeholders. There exists a range of tax- specific and corporate responsibility reporting requirements and initiatives to drive 'good' behaviour. It remains the responsibility of the company to ensure the effectiveness of its reporting and to sustain an environment of trust with its stakeholders.

Bearing in mind the limitations of the high- level survey that SAICA undertook, it is interesting to note that non- tax practitioners (as compared to the tax practitioners):

1. Access a variety of information sources;
2. Indicate that a greater degree of improvement of the tax disclosure characteristics is necessary; and
3. Suggest that there are gaps in meeting user information needs.

Future work and research should consider exploring in more detail user views on e.g., the transparency and usability of tax disclosures, and whether the existing frameworks are in reality meeting those needs.

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## Survey Questions

1) To what extent do you rely on tax disclosures in your decision- making?

   Scale: Very frequently, frequently, occasionally, rarely, never

2) For what purposes do you use tax disclosures?

3) Which report/s, in addition to the annual financial statements, is your main source of information on a company's tax disclosure?

   Sustainability

   Integrated

   Other

4) In your opinion, to what extent do current tax disclosures demonstrate the following characteristics?

   Usefulness

   Balance

   Understandable

   Transparency

   Context

   Scale: Poor, Fair, Good, Very Good, Excellent

5) What improvements to the current tax disclosures would you suggest that companies consider?