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Global taxation reform

Global Annual Review 2013

PwC Vice Chairman, Global Tax Rick Stamm discusses how tax systems worldwide should be updated to meet modern needs and priorities; and that doing nothing is no longer an option.

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Global taxation reform:
Why a new world economy needs a new tax system

By Rick Stamm

Rick Stamm

PwC Vice Chairman, Global Tax

In the current economic environment, the priority for governments worldwide – and Western governments in particular – is for their tax systems to generate the level of revenues they expect. This focus is reflected in a strong public sentiment that everyone should 'pay their fair share'.

Inevitably, 'everyone' is often defined in popular parlance as large corporations. And asked whether corporations are paying their fair share of tax, growing numbers of people appear to believe – rightly or wrongly – that the answer is "no".

Five imperatives for companies

Against this background, the media, politicians and NGOs worldwide have engaged in a sometimes heated debate about the ethics and legality of various multinationals' tax policies, often with significant impacts on the reputations of the companies concerned. And the knock-on effects go much further. Our client conversations and 16th Annual Global CEO Survey both confirm that tax has moved up the agenda of business leaders around the world.

There are several reasons for this. Companies are not only concerned about an increasing tax burden, but are also aware of changing public attitudes that are threatening to evolve into even more stringent tax regimes. They also know that their tax policies – even if perfectly legal – can now present significant risks to their corporate reputation. So tax issues need to be considered, discussed and communicated more carefully than ever before.

This broad requirement can be divided into five key imperatives that we're encouraging our clients worldwide to meet. The first is to understand the differing perspectives and priorities of their various stakeholders – from investors to customers, and from media to governments.

The second is to set a clear, comprehensive and explicit policy on all aspects of tax planning, discussed and agreed by the board.

Third, companies need to decide whether greater transparency around their tax affairs is appropriate – and, if so, how best to communicate the key messages.

Fourth, they should decide the extent to which they want to get involved in the public debate over domestic and international tax: this is not an area where the maxim 'any publicity is good publicity' always applies.

Fifth – and most important – they need to avoid surprises. Across the world, legislation and social attitudes around tax are in flux, and companies need to monitor these carefully and to constantly stay ahead of events.

What's 'fair'? What's 'compliant'? What's neither?

These actions can help companies manage the symptoms of the global controversy over corporate taxation. However, they do little to address the wider problem that the global corporate tax system itself is now outdated, overly complex and increasingly unworkable.

These fundamental shortcomings have been reflected in the muddled thinking exhibited all too often during the ongoing public debate. People demand more 'fairness' without defining what this would mean. They condemn as 'unethical' some tax treatments that comply fully with legislation. And they blur the division between tax avoidance and tax evasion.

What's clear is that concern over taxation will not simply blow over – and that a way forward must be found to fix the system. To make progress, the discussion needs to focus more clearly on what a fairer tax system would look like, how it could be enshrined in laws and regulations, and how people committing abuse under those laws and regulations might be identified and penalised. The first step is to establish the parameters for the debate.

Helping Summa Group drive its expansion into ports and logistics

Following private holding company Summa Group's previous investments in the logistics business, including sea ports and oil and gas terminals, its 2012 acquisition of Fesco Group would prove to be a landmark deal.

As Russia's largest private transportation group, Fesco was a key target. The acquisition would position Summa to consolidate its status as a leader in the global ports and logistics market. Needing to complete the 70% acquisition of Fesco against a challenging deadline, Summa turned to PwC Russia, its preferred tax adviser, for assistance.

The deal would turn out to be one of the largest and most complex acquisitions in the Russian market that year. Galina Naumenko, Tax partner, and Julia Igolkina, director in PwC Russia's Tax & Legal Services practice, pick up the story: "Having been appointed as Summa's tax advisers for this deal in May 2012, we needed to move very fast to complete the due diligence and all other tax services required in this transaction." Galina, Julia and their team were confronted with a number of challenges, all of which had to be overcome for a successful outcome.

To meet Summa's requirements, PwC Russia needed to model tax implications in relation to debt and dividends' distribution across various scenarios in three different jurisdictions. Pre-completion, the Moscow team also worked with Summa and Fesco to pave the way for a successful integration of the two businesses.

Since the deal completed in December 2012, Julia and her team have been closely involved in advising Summa on refinancing of the acquisition debt, successfully completing a Eurobond issue and a Rouble bond issue that have raised in total over US$1 billion. Ongoing projects are focused on further consolidating the integration with Fesco.

Commenting on the closing of this acquisition, Summa's President, Alexander Vinokurov, sums up: "We're confident that the acquisition will enable [Summa] to extend its geographical reach. Fesco is one of the largest integrated players in Russia's container and rail market, having its own fleet, rolling stock and container fleet, as well as a network of 70 sales offices in 15 countries and its own port facilities in the Far East. Fesco's business will soon be fully integrated with Summa Group's transportation and logistics business."

Novorossiysk Commercial Sea Port, Russia

The largest Russian port operator, partly owned by Summa Group

Governance and economic policy development in Tonga

Following the recent democratic settlement under its 2010 constitution, the Kingdom of Tonga has taken significant steps towards political and economic development. The Kingdom is made up of over 170 Pacific islands and is a member of the Commonwealth of Nations, a voluntary association of 54 countries that support each other and work together towards shared goals in democracy and development.

At the beginning of 2013, the Commonwealth's main agency – the Commonwealth Secretariat – at the request of the Tongan Prime Minister's Office, turned to PwC UK to help consolidate the Kingdom's achievements to date and accelerate future progress.

Commissioned to provide policy advice on governance and accountability in the development and implementation of tax and economic policy, a PwC team supported by Dr. Wilson Prichard of the University of Toronto, arrived in Tonga in February 2013 to conduct an assessment. The team conducted 38 interviews over eight days with key government representatives, including the Prime Minister, senior tax policy and economic policy representatives, business and community leaders, the CEOs of the Ports Authority and Airport Authority, and the Governor of the Reserve Bank.

Prior to this in-country mission, the team had also carried out an extensive review of the literature in the area of tax and economic policy, and participated in information-sharing with several of the international organisations currently operating in Tonga.

Chris Wales, director for PwC UK's Tax group, sums up the results: "Real progress has been made towards the Kingdom's objectives for political and economic development. However, more needs to be done. Our research identified certain features of the Kingdom's historical economic legacy, such as reliance on remittances from Tongan ex-patriots and the unique land tenure system, which still need to be addressed."

A written report of the team's findings and recommendations will be presented to the Prime Minister's Office and the Commonwealth Secretariat towards the end of 2013. The report aims to holistically examine the Kingdom's governance and policy environment to highlight important challenges and provide a number of possible policy options to address them.

It is anticipated that the report's pairing of holistic policy analysis and an examination of the governance implications of policy recommendations will deliver lasting benefits to Tonga. The policy options discussed in the report will offer pragmatic, 'Tonga-specific' policy advice, avoiding a 'one-size-fits-all' approach that has characterised much of the external assistance offered to Tonga in recent years.

The report will also allow the Prime Minister's Office to conduct effective and robust dialogue with other areas of government regarding the economic and political issues facing the Kingdom. Above all, the team is confident that this will provide valuable insight and opportunities for supporting the Kingdom of Tonga's onward political and economic development.

It is clear that a significant contributing factor to the tax avoidance problem is caused by governments that try to compete by creating favourable tax regimes.

Two forms of 'tax abuse'

To do this, it's important to recognise that the discussion on tax abuse falls into two categories. First, there is 'pure' tax evasion – the illegal acts of citizens or businesses that simply ignore a country's laws or hide their income, so depriving governments of their rightful tax receipts. Interestingly, when the US measures its 'tax gap', it finds that it mainly comprises unreported individual income or employment taxes.

The issue of taxes lost due to unreported income is a major issue in virtually every economy – and a seemingly intractable one. Yet, there are ways to capture some of this tax. Transparent sharing of information between countries can help. Governments also need to do their part by clarifying the penalties for non-compliance and directing their tax audit resources towards the most likely points of evasion, while using electronic information more actively to verify individuals' reported income against other data.

The second area of discussion is tax avoidance, or 'aggressive' avoidance as it's often termed. This sort of planning, frequently depicted as 'legal but not ethical', has been the primary focus of public debate. Given the complexity of tax laws, some of the deep misunderstandings exposed during this debate may be understandable. However, the biggest problem with the current debate is that it threatens to obscure the real issue at hand: that the international tax system is in urgent need of overhaul.

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Adjusting to the new economy…

Why is an overhaul needed? For most of human history, the world has run on a goods economy – with the result that the tax systems still in use today evolved to administer the exchange of physical products. Value creation was tied to geographic location: a company's products were designed, manufactured in, and shipped from one place. Differences in tax regimes were relatively few and easy to understand, and managing them generally involved making choices about the legal structure and location of a business.

Today, the global economy is driven by intangibles like brand, intellectual property and the exchange of information – and even the smallest businesses can operate globally. But tax codes force decisions to be made about where to record something inherently global and largely intangible: we can download an app in London that was developed in a bedroom in New Delhi and distributed by a corporation in Silicon Valley. Where is the value created? How should it be recorded? And if the tax laws are changed unilaterally by one country, how does that affect the overall tax position?

…and a competitive global tax market

This rising global complexity has been compounded by competitive moves at national levels. As tax codes have evolved, governments – often with the best intentions – have designed laws to support national priorities such as foreign investment and job creation. And because corporate taxes are a cost of doing business in their country, governments try to attract investment by minimising this cost.

Quite rightly, corporations then plan their activities so they can claim the reliefs to which they are entitled. However, to encourage the behaviour they want, governments should also provide certainty both about the protection they extend to companies that comply, and also the penalties they apply to those that don't. As our latest Global CEO Survey shows, lack of certainty – on taxes or any other issue – undermines business confidence and impedes economic activity.

In this complex and shifting global tax environment, PwC's experience shows that the vast majority of companies have been genuine in their efforts to comply with existing laws. Professional networks like ours play a role in helping them do this.

Progress is being made, with recent meetings of the G20 and G8 highlighting the need to clarify taxation of international commerce.

PwC's Global Tax Code of Conduct, originally written in 2005 and revised this year, mandates that we provide tax services grounded in national and international law, properly disclosed and supported by actual facts and circumstances. We clearly say that there are certain types of planning arrangements which, although legal, PwC firms should not propose or recommend implementing to clients.

As a result, we advise against certain kinds of tax planning, which we believe do not fit the applicable laws or which could damage a company's reputation. We also play what we believe is an important and positive role in the tax systems of the countries where we operate. In essence, we help these systems work.

Towards a new system

Nevertheless, the best of intentions may not mix well with national and global tax systems that are increasingly outdated. An overhaul is needed. The place to start is with a robust and frank assessment of whether current tax systems are still fit for purpose. And the simple answer is that they aren't, because they were created for a world very different from today's.

The basis on which the US taxes international transactions was laid down in 1962. In the UK, key elements date from 1965. The core of the OECD's model for international taxation originates from the 1970s. If tax codes are to adequately serve national priorities and values, they must also reflect the realities of today's global economy.

However, efforts to update today's tax systems raise further questions. No single country can deal with the problem alone. For example, in some circumstances under current law, the cross-border aspects of existing rules can result in legal tax avoidance that no country actually intended. Likewise, one-off actions to correct these issues risk making single streams of income subject to multiple taxation claims, and impeding global investment and trade flows. So governmental cooperation and coordination is essential.

Progress is being made, with recent meetings of the G20 and G8 highlighting the need to clarify taxation of international commerce. There is a growing global consensus that comprehensive reform of tax laws and treaties is needed to create a balanced, modern and effective tax system. This will take time, and governments will need proactive input from business. But given this input, and a concerted collaborative focus by governments, a lasting outcome is achievable.

Updating the global tax systems is not a simple undertaking. But we do not live in simple times – and doing nothing is no longer an option. We need to move on from debating the merits or shortcomings of individual corporate tax policies, to consider how tax systems worldwide can be updated to meet modern needs and priorities. The world has moved on. Tax systems need to do the same – and soon.

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Complex tax advice for a landmark forestry project in Uruguay

Montes del Plata (MDP) is a forestry company founded in Uruguay in 2009 to produce and export eucalyptus cellulose pulp to major markets worldwide. The business was created through a merger between the local operations of two major forestry companies – Arauco, a leading producer of woodpulp, sawn timber and panels; and Stora Enso, a leading manufacturer of paper, board and wood products.

MDP made significant investments in technology, research and plantation improvements, to develop a sustainable forestry base that will supply the new pulp mill that is currently being built in the Colonia Department of Uruguay. The industrial complex under construction includes a state-of-the-art mill powered by a biomass-based generation unit, and a port terminal to handle exports and incoming supplies.

MDP´s pulp mill is the biggest private industrial project ever undertaken in Uruguay. The company estimates that the investment will total around US$2 billion, boosting Uruguay's gross national product by 2%. When setting up the project, MDP chose PwC Uruguay as its tax consultants, because of our depth of experience in similar forestry and industrial projects, and our strong background in cross-border investment initiatives.

The PwC team worked closely with MDP's management to provide tax advice for the construction process and future operational phase. Our support included introducing the project to the Uruguayan government, and providing high-level professional services from the start of the project. In particular, we played a decisive supporting role in the negotiations with the Uruguayan government that led to the signing of an investment agreement authorising the creation of a privately-owned Free Zone for the industrial project.

Further tax matters handled by the PwC team included assisting MDP in its negotiations with its contractors and the multinational institutions that ultimately financed the project.

Daniel Garcia, PwC Uruguay tax partner and Forest, Paper & Packaging leader, comments: "Through the combination of our multidisciplinary team specialising in the Forest, Paper & Packaging sector, our extensive knowledge and expertise in these types of projects, and our continuing investment in long-term relationships, we have been able to deliver high-quality services within the challenging deadlines that the project required."

MDP Chief Financial Officer Diego Wollheim adds: "A project of this magnitude requires a careful analysis of the tax issues and to work together with the government to secure sustainable conditions for the development of the project. At PwC, we found a professional team with the knowledge and experience to cope with these challenges that can be considered unique in the history of the country."

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