

Editorial

Challenges for a listed multinational enterprise doing business in Europe

Paul Morton, *President Confederation Fiscale Europeenne, Head of Group Tax, Reed Elsevier Group plc*

Investors in mature companies whose shares are listed on a stock exchange are looking for stable and sustainable after-tax earnings. They are also looking for evidence that a company is well managed, in particular, the absence of any surprises. Surprising good news regarding a tax matter might be just as indicative of management weakness as unexpected bad news as the markets expect to be well briefed and prepared for significant changes. Investors are also looking for clear and understandable financial reporting.

This translates into some key objectives for the corporate tax department. It must deliver a stable and sustainable effective tax rate (as reported in the accounts) and a stable cash tax position. The tax rate should be explainable to the market. Finally, the financial statements of the company together with management commentary should clearly set out the tax position of the company.

The case of Enron provides a good example of a tax rate which could not be explained. A document, available on the web, entitled 'Written testimony of the staff of the Congressional Joint Committee on Taxation on the Report of Investigation of Enron Corporation and Related Entities regarding federal tax and compensation issues and policy recommendations' indicates that 'Enron reported financial statement net income of \$2.3 billion, but tax losses of \$3 billion for 1996 through 1999'. This is hard to understand until reading further in the paper 'from 1995 until Enron filed for bankruptcy, Enron achieved more than \$2 billion in tax and financial accounting benefits and paid approximately \$88 million in fees paid to advisers and promoters'.

Today, the emphasis is on responsible behaviour by large corporate taxpayers. Many of the larger multinationals are developing a formalised tax policy which is approved at Board level. Some policies are available to read on the web, such as the excellent document published by Vodafone. Invariably, companies will seek to comply fully with relevant law in all countries in which they operate. Some companies state clearly that all of their tax planning will be based around commercial projects. Few companies, in the current climate, engage in wholly artificial tax planning.

The tax environment and the demands of investors pose a number of particular challenges for the tax

director. The most commonly cited international tax issue is, of course, transfer pricing. The Ernst & Young biennial report demonstrates that this remains the most important international tax issue for companies and that the financial impact is constantly increasing. This is fully recognised by national tax authorities, many of which are increasingly providing guidance and encouraging the use of advance pricing agreements. It also has to be said that tax authorities continue to look to transfer pricing to yield more and more tax revenue so companies must be as well prepared as possible with sound transfer practices and good quality documentation. It is also, of course, a priority area for the European Commission and the work of the European Transfer Pricing Forum is highly valued by industry. However, a question which is hotly debated is whether the common consolidated corporate tax base is the answer to this problem for the larger companies or whether all efforts should be made to improve the administration of conventional transfer pricing. It is not difficult to list some of the difficult technical problems associated with CCCTB including the interaction with third countries (how to deal with corresponding adjustments) and how to account for acquisitions and divestments where all or part of a target is in a different CCCTB grouping. On the other hand, it is easy to see that in many instances there could be a considerable saving in compliance costs. There is a need for more research on the question of compliance costs and turning to the key objectives of a multinational company, the question to be asked is whether CCCTB would contribute to stability and sustainability of the effective tax rate. If the apportionment keys, for example, were subject to as much volatility as current transfer pricing arrangements the result may be no more satisfactory for large companies than the conventional approach. To put it another way, compliance cost is not necessarily the most important factor for a large multinational. Stability and certainty may be much more significant in terms of shareholder value. Certainty, for example, may be achieved through binding arbitration between competent authorities, the subject of much welcomed ongoing OECD consultation.

Another challenge is clearly that of complexity. Even a fairly straightforward commercial transaction can necessitate the expenditure on professional fees of

tens or hundreds of thousands of euros as expert advisers consider highly complex legislation in more than one jurisdiction to ensure that no pitfalls are encountered. While some twenty years ago it was possible for a practitioner in the UK to claim to be an expert in all areas of taxation there are few who would be sufficiently knowledgeable or courageous to make that claim today.

Every corporation needs to remain competitive in relation to its peers. Failure to deliver comparable after tax returns will result in a falling share price and exposure to being acquired either by a competitor or, perhaps, by private equity. A tax director will have to ask whether there are tax planning opportunities which are exploited by competitors which should be adopted by his or her own company. Few large companies will wish to follow the most aggressive tax planners but there is clearly a middle ground where difficult questions will arise.

Finally, of course, there are huge challenges connected with proper compliance with the *Sarbanes Oxley* section 404 regime which applies to all companies listed on a US stock exchange. Tax accounting has also become much more complex

with the largest companies having to account under international financial reporting standards, US GAAP (for US reporting) as well as under various local accounting standard for local statutory accounts. The intricacies of tax accounting under international financial reporting standards and conversion to US GAAP are not for the faint hearted.

Faced with these challenges, tax directors can draw comfort from the ever-expanding body of academic research and thinking on international tax matters and the many opportunities for interaction between academics and practitioners. To name just two initiatives, there is the recently formed European Tax Policy Forum and the Oxford University Centre for Business Taxation. These are engaged in independent objective research while being sponsored by industry. All over Europe there are countless interactions between researchers and academics and the corporate sector and its advisers. There is, too, a high level of consultation with the European Commission and the OECD as well as member state tax authorities. All of this suggests that opportunities abound for well-reasoned and researched improvements in the corporate tax environment in Europe.