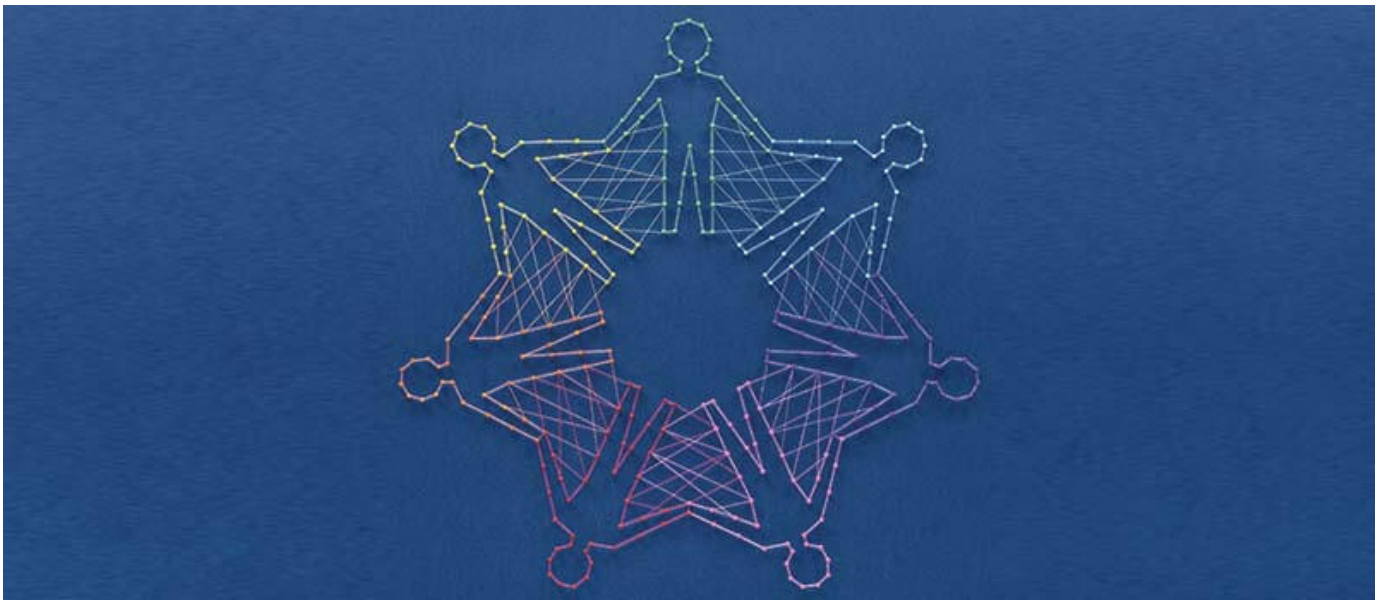
Tax morale: trust and belief in the tax system

Large Corporate | Management of taxes



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Key Points

What is the issue?

Being a good corporate citizen necessitates that business follows both the letter and the spirit of the law – paying the right amount of tax, in the right jurisdictions, at the right times.

What does it mean for me?

Increased levels of mutual trust between tax administrations and multinational enterprises could be a win-win outcome for all stakeholders.

What can I take away?

The OECD's recent report 'Tax morale II: Building trust between tax administrations and large businesses' provides practical ways to boost tax morale and therefore improve the intrinsic willingness of businesses and other taxpayers to pay tax.

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Tax used to be an advisory discipline. Now, it is an area of focus for many boards and among a wide range of other stakeholders. Stephen Pearce, CFO of Anglo American, noted that: 'Citizens increasingly want to understand the value and the costs that business are bringing to their societies, and investors want to be able to undertake sophisticated analysis of risks, alongside reassurance that their capital is supporting sustainable and responsible businesses.'

It may not be something that all tax technical practitioners will be thinking about on a daily basis when solving technical challenges, but individuals and businesses pay taxes to support countries in their provision of services and welfare. The payment of taxes is not only a legal requirement; it is a moral requirement too. Being a good corporate citizen necessitates that business follows the letter and spirit of the law – paying the right amount of tax, in the right jurisdictions, at the right times.

The law is complex. On occasion, it might not be beyond doubt what the 'right' amount is, and a good corporate citizen needs to recognise this challenge. This is no longer just viewed just as good corporate governance. It's also a key sustainability metric; the sustainability of a business is underpinned by the sustainability and integrity of the tax systems with which that business operates. Tax morale is a critical feature of this.

What is tax morale?

Tax morale is the trust and belief in the tax system which influences tax compliance behaviours and therefore the intrinsic motivation to pay taxes. Research by the OECD tax morale workstream 'aims to encourage research, dialogue and actions to deepen the understanding of tax morale, as well as the policies that enhance it'.
It has been found that in countries with a high level of trust in a fair and effective tax system, there appears to be correlation with the willingness of taxpayers to follow the letter and spirit of the law.

For tax administrations, several tight years – fiscally driven by events such as the covid pandemic, international political events and rising costs of living – mean that pressure on tax receipts is unrelenting.

As businesses change and adapt, tax officials have an increasing need to better understand the ways in which multinational businesses operate. For businesses themselves, recent years have seen rapid change throughout supply chains, while globalisation often blurs the traditional tangible/intangible boundaries. There has also been a greater focus on topics ranging from tax transparency to corporate governance.

OECD’s report on tax morale

The OECD recently released its second report on tax morale: ‘Tax morale II: Building trust between tax administrations and large businesses’ (see bit.ly/3VTjDcS). As well as useful research, this provides practical ways to boost tax morale and therefore improve the intrinsic willingness of businesses and other taxpayers to pay tax.

The findings of the report are applicable to all jurisdictions but focus primarily on developing countries. These are typically the jurisdictions which are most reliant on tax revenues from large businesses, suffer the most if there is tax avoidance and may face larger capacity challenges. Although previous research suggests that tax morale may be lower in these regions, they have the most scope for improvement. Regional differences exist in the findings and can also vary by stakeholder group.

The main way in which the report envisages achieving a boost in tax morale is by enhancing co-operation, trust and confidence in the tax system between taxpayers and tax administrations. In some countries, this may be realised via the strengthening of co-operative compliance approaches, while in others a gradual improvement of communication channels and trust between the relevant parties will be a more natural first step.

The report builds on the previous OECD report (2019), which showed that trust in the tax administration can be a key driver in tax morale, and that it may be relatively easier for tax administrations to become trusted by business than vice versa. However, this does not mean that taxpayers wanting to improve morale should sit back and wait for tax administrations to take the first step – building trust is a two-way street.

The latest report includes further research, including the findings of surveys of multinational enterprises (MNE) on the principles of obtaining greater tax certainty, and the perceptions of over 1,200 tax officials from 138 jurisdictions about their perceptions of MNE adherence to the OECD's 2013 best practice statement on engaging with tax authorities in developing countries (see bit.ly/3X1QHAX).

The OECD held a series of regional roundtables with stakeholders from both tax administrations and business which helped it to develop a range of recommendations for how tax morale could be improved through the actions of each, and by working together.

What can we do to improve morale?

The OECD notes that: 'Responsibility for building trust and improving transparency and communication is shared between taxpayers (and advisors) and administrations.' There is no silver bullet that either tax administrations or businesses can deploy to quickly maximise tax morale. However, there are things that each can do to build trust between them and lead to a virtuous tax morale circle.

MNEs have highlighted the importance they place on resolving areas of tax uncertainty in an efficient manner. From the perspective of tax administrations, better prioritisation of their enforcement activities towards high-risk taxpayers could generate resource savings (both cost and time), while still allowing tax administrations to be satisfied that taxpayers with robust levels of tax morale will readily fulfil their obligations and be willing to provide this comfort in a range of open and transparent ways that demonstrate their values. Increased levels of mutual trust could therefore be a win-win outcome for all stakeholders.

Chapter 3 of the OECD's latest report provides specific recommendations, as well as identifying areas where further work is required. The findings are grouped into four broad categories:

- compliance and audit strategies;
- expectations and accountability of behaviour;
- transparency and communication; and
- capacity building.

Feedback reveals that the lack of understanding of business structures and value chains is a common challenge faced by tax authorities around the world. Since understanding of these areas sits overwhelmingly in the private sector, more business expertise is needed to support capacity building initiatives. The report also highlighted the mutual benefits of co-operative compliance programmes. Businesses can play a key role in supporting tax administrations to develop these relationships by sharing their experiences in other countries and discussing their risk management framework with the tax authorities. Improving expectations and accountability for behaviours are highlighted as key areas to explore.

The business response

Business at OECD (BIAC) welcomed the OECD's work on tax morale, and its recommendations (it had been consulted in the design of the OECD's survey, and participated in the roundtables). As an immediate response, BIAC has rewritten its paper on engaging with tax administrations in developing countries (see bit.ly/3VY2AXo), intending it to represent an aspirational framework for MNEs when engaging with authorities in developing countries. The ten best practices are set out below.

Governance

1. Businesses should follow established and agreed-upon procedures and channels when dealing with tax authority officials.

2. Businesses should make the payment of their tax liabilities within established due dates.

3. Businesses should recognise the capacity challenges that tax authorities in developing countries may face. This should impact how the business resources its own tax functions, how it approaches engagement with the tax authorities, and how it may look to provide assistance.

4. Businesses should not engage in bribery, corruption or tax evasion and should take proportionate steps to mitigate any related risks.

Trust and compliance

1. Businesses should seek to build trusted relationships with tax authorities.

2. Businesses should co-operate with tax authorities and respond in a timely fashion to enquiries.

3. Businesses should not undertake transactions with the sole purpose of creating a tax benefit that is in excess of the reasonable interpretation of relevant tax rules. They also should not use artificial arrangements, structures or contracts to reduce their taxes, nor utilise tax incentives or exemptions inappropriately.

4. Where businesses engage in public policy advocacy on tax, they should seek to shape future tax policy and legislation in ways that create shared value in enhancing a transparent and constructive relationship with tax authorities.

Transparency

1. Businesses should be open and transparent with tax authorities by providing as much relevant information as possible to help to address queries or issues in an efficient manner.

2. Business should recognise the interest of their stakeholders and the public in their tax affairs, and should provide relevant public information on their economic contribution and taxes paid.

Each of these best practices is now supported by additional commentary, a narrative explanation and examples intended to show tax administrations and other stakeholders how they might be delivered by taxpayers, and some of the challenges that taxpayers may face in doing so.

These best practices are not intended to be binding requirements for business but should be viewed as guiding principles to follow. While many MNEs already implement the principles, they should be used as a helpful tool for businesses in all sectors that are seeking to develop trusted relationships with tax administrations.

Next steps

The OECD will be undertaking further research, and working with partners to try to deliver a range of initiatives in line with the recommendations, including within its existing Tax and Development capacity building initiatives.

Business at OECD (BIAC) encourages its member federations and businesses to endorse the best practices. Tax administrations (particularly in developing countries) should look to the best practices as a way to engage with taxpayers and build out their domestic governance requirements. Businesses should look to the best practices and critically assess whether they are meeting them. If so, they should be prepared to explain how this is being achieved. If not, they should be asking themselves ‘why not?’ and considering how to bridge any gaps.

Business at OECD (BIAC) will also seek to work with the OECD and other stakeholders in the coming years to provide expertise and support to tax administrations in helping them shape their contributions to improve tax morale and build capacity, as well as exploring other initiatives that business can take directly.