Law . Tax

Ethics: the future of tax planning?

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Contents

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Foreword

Tax planning, once a legitimate element and facilitator of international trade, is now widely seen as morally and ethically wrong. But the dramatic downgrading of tax planning's status – from smart business to 'sharp practice' – is relatively recent. The financial crisis of 2007/2008 exposed the inner workings of international business and finance like never before, and its aftermath continues to be characterised by ongoing investigations into and debates over the role of commercial, financial and fiscal regulation. Tax planning became "aggressive tax planning" as an enabler of "tax avoidance".

Morality and ethics now dominate the international tax planning landscape, raising major questions for companies, legislators and advisers. Even in specific cases, the issues are rarely black and white. In this guide we aim to shed some light on the grey areas and set the debate in context. While we cannot claim to have definitive answers to the complex questions involved or to cover the myriad variations involved, we do offer some practical pointers for best practice.

In *Are ethics the antidote to aggressive tax planning?*, we examine the emergence of ethics and morals as the background to and framework for corporate tax planning and regulation. While the notion that companies and individuals should pay their "fair share" of tax is widely accepted in theory, "fairness" itself is equally wide open to interpretation. We question whether such subjective and contentious concepts can lead to truly effective, practical and internationally accepted practices, arguing that greater legislative consistency and clarity is required to deliver on a shared responsibility.

Tax – a reputational and boardroom issue, outlines the ways that tax policies and practices now have a major influence on perceptions of corporate citizenship and business reputation. The age of instant communication has accelerated the process towards a world where companies openly providing tax information – not just on their tax policies and practices, but also on tax risks – will be business as usual. Specific anti-avoidance measures and more "catch-all" – and, in many cases, legally vague – measures employed by the tax authorities can only go so far. A new approach to countering sophisticated international tax structures is now taking shape: criminalisation and stigmatisation. Targeting the heart of a company's reputation strikes a chord in the digital age, and boardrooms should take note.

If dubious tax practices are a clear route to notoriety or worse, can an openly ethical approach to tax give companies a positive competitive edge? This is the theme of *Ethical tax behaviour – a competitive business advantage?* Despite the negative press, finding a source of low tax cost advantage is still a legitimate competitive practice used by companies and, to varying degrees, by the States in which they operate. But the economic argument for devising sophisticated international tax structures must take account of the current focus on corporate ethics. Above all, it must ring true with the company's approach to corporate social responsibility (CSR). We outline the advantages of and limits to using ethical tax behaviour as a competitive strategy.

At the same time as society at large is becoming more inclined to overlook the distinction between tax avoidance and tax evasion, legislators across the globe are increasingly moving to criminalise tax evasion or the facilitation of tax evasion. We discuss the compliance implications for companies in *Corporate criminal liability for tax evasion: a view from the UK, France and Italy*, and offer practical tips for risk management.

As regulators introduce stronger penalties and a more targeted approach to enforcement, one tax risk facing even the best run businesses is the cost and upheaval of a tax investigation. *Best practice focus: Preparing for a tax investigation in Poland* takes a close look at the process in Central and Eastern Europe, offering observations and insights on effective preparation that resonate well beyond the region.

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Are ethics the antidote to aggressive tax planning?

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There was a time when tax planning was an acceptable way for corporations to mitigate costs. Cost-cutting, profit maximisation and shareholder value aligned with the Friedmanian ethics of the day. That time has long gone. Over the past ten years, tax planning – or at least a certain interpretation of tax planning – has been deemed morally wrong.

Ever since the OECD (Organisation for Economic Co-operation and Development) tagged the emotive, and very subjective, "aggressive" on to tax planning, there has been much hullaballoo over corporate tax policies and practices. Indeed, "aggressive" implies moral appraisal of tax planning – and when moral appraisal comes to the fore, ethics and all their accompanying grey areas are not far behind.

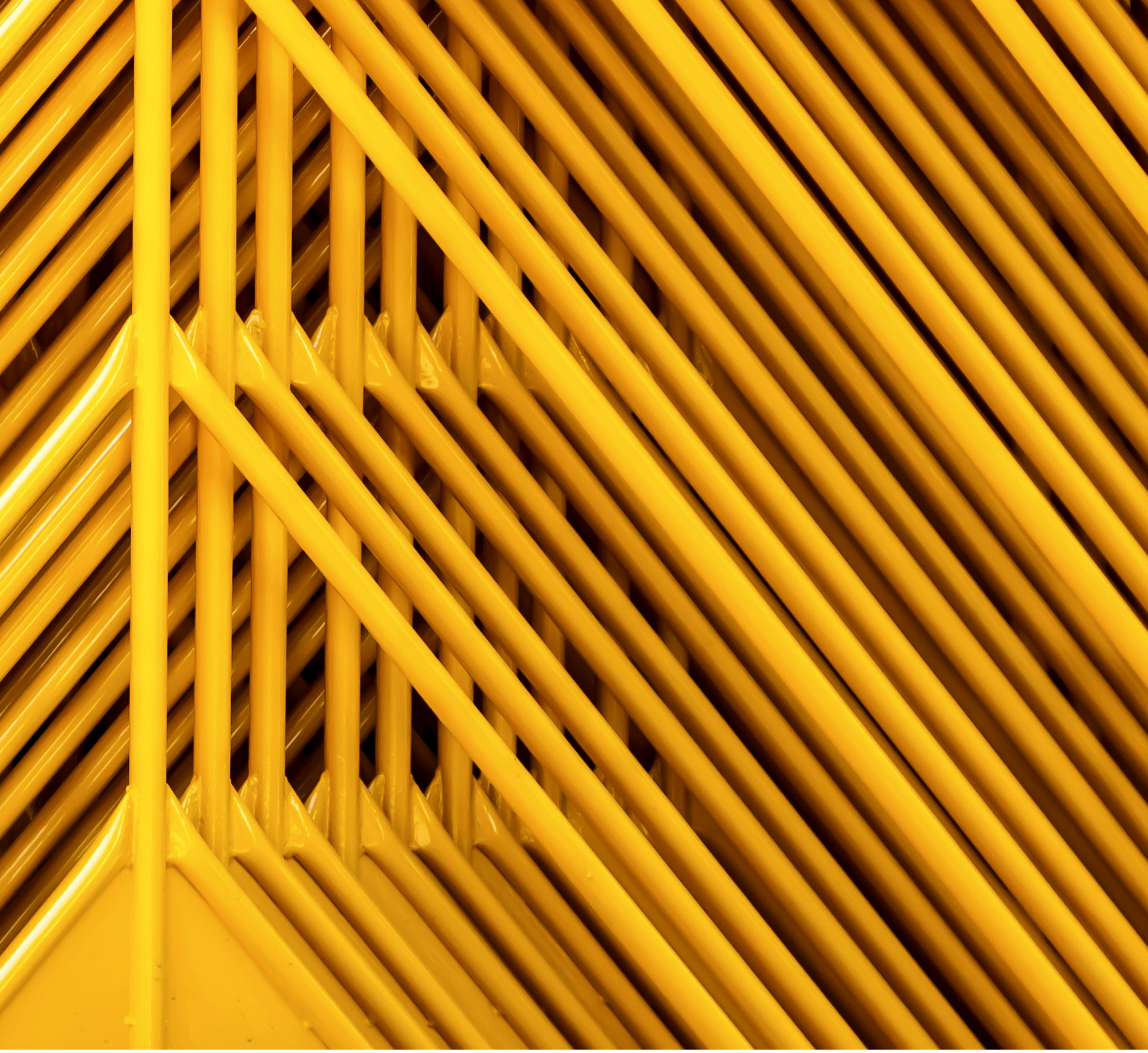
Corporates as moral actors

In a post financial crisis world, corporations are being urged to behave ethically, which, according to the Merriam-Webster dictionary, means in a way "conforming to accepted standards of conduct". So, for want of clarity and sharpness in the definition – along with fear of reputational damage – companies focused on corporate social responsibility (CSR) and included tax planning practices in the process. The public outcry over the Starbuck's case is a perfect case in point: where one claims to feel embedded in society and therefore attaches great interest to trust at all levels – with trade partners, customers and the wider society – one cannot indulge in aggressive tax planning.

It does make sense to consider companies as moral entities rather than mere legal entities. They act according to their specific organisation, making their own decisions that may have an impact on other stakeholders. Therefore, considering that "tax revenues provide governments with the funds they need to invest in development, relieve poverty, deliver public services and build physical and social infrastructure for long term growth"[1], corporations must plan their tax affairs to the extent that they contribute to society through payment of their fair share of taxes.

As part of their CSR approach, multinational corporations may endorse a 'tax code of conduct' describing the principles and general framework that guides their group tax affairs and relations with their clients and the tax authorities. The general idea is to highlight that the group does not encourage or promote tax evasion and is very much concerned with paying its fair share of tax. Ethical debates are brought to fever pitch where the corporation enshrines a "main purpose" test rule in the tax code, sometimes long before its introduction in legislation. But what if the code does not include internal procedures to be carried out when a member of staff fails to comply with its provisions? If so, the whole code fails to make sense and remains mere wishful 'ethical' thinking.

[1] OECD, *What drives tax morale?*, March 2013



Paying a fair share of tax: a shared responsibility

Corporations cannot be the only ones to be held morally responsible for their actions, however. Determining a fair share of tax is a matter of shared responsibility with the State, as the appropriate amount of tax to be paid by corporations is initially set in law.

The concept of paying a fair share of tax is a key element in the implementation of CbCR (country-by-country reporting). CbCR was introduced by the OECD as an addition to transfer pricing documentation, but it has nothing to do with the arm's-length principle for information provided in the country-by-country report. It is based on consolidated information, which by definition eliminates all intercompany transactions within the scope of transfer pricing rules. CbCR is nothing more than a means to identify situations where profits have been allocated to low substance or low tax countries – and therefore fosters the assumption that those situations are not compliant with applicable tax rules. Furthermore, country-by-country reports filed by multinational corporations may become public information. This would certainly lead to misinformed finger-pointing, as the public would have access to rough data collected for review and use by tax authorities and not for the public eye. Each and everyone's take on "ethics" would then become overwhelming.

Impartiality and equal treatment should be the cornerstones of any tax legislation. States have the option of using taxation to attract non-resident companies to create employment and tax revenues. But they do so at the expense of the integrity of the international tax system as they create harmful competition. Where the OECD and the EU have got to grips with aggressive corporate tax planning, their ongoing works mostly fail to acknowledge the part played by governments in deliberately reducing some corporations' tax burdens.

More legislative consistency and clarity, fewer ethical grey areas

The fairness of the system should also be guaranteed by tax legislation. In this respect, further to the OECD/G20 base erosion and profits shifting (BEPS) initiative, lawmakers have implemented provisions challenging transactions deemed unethical in the wake of the 2008 financial crisis. The restrictive rules on interest deduction included in the EU's ATAD directives[2] offer a prime example: when these were introduced in 2016-2017, the use of hybrid entities and instruments was then one of tax planning's key elements, as it relied on differences in analysis of legal agreements between States. Where tax legislation was by nature based on a unilateral approach to transactions, skilled tax professionals would use their multi-jurisdictional knowledge to structure tax-efficient financing which complied with two or sometimes three countries' tax rules, and general anti-abuse rules would typically not apply to such transactions. To counter this, both the OECD and the EU designed specific anti-abuse rules, and therefore made illegal what was up to that point merely unethical.

But legislation may lack consistency and certainty, leaving taxpayers with the responsibility of deciding how they use the rules. Taxpayers should be able to abide by the letter of the law to plan their tax liability. This would be fair all round – and provide a good measure of the fair share of tax to be paid. But as law is so often poorly drafted, it leaves room for tax planning approaches that are labelled aggressive. To counter these practices, lawmakers and courts have relied on the spirit of the law or the intention behind the letter of the law. The scope of tax planning is then broadened to ethics as it implies a moral evaluation of any business operation.

General anti-abuse provisions which have flourished in both domestic and international tax rules[3] in recent years set an example. According to such provisions, a business operation may be disregarded if it has been set up not only with the sole purpose, but with the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of legislation. The tax authorities are then allowed to disallow any arrangement that has resulted in a lower level of taxation than the one they deem to be acceptable. While case law shows that it is an ordeal in itself to determine the sole tax purpose of an operation, how can the "main" purpose – let alone "one of the main purposes" – of an operation be safely assessed? How then can taxpayers determine their fair share of tax where legislation fails to be consistent enough to do so itself?

Tax advisers may have an answer. But where do they stand, torn as they are between their commitment to their client and their own moral and legal responsibilities?

Tax advisers: walking the fine line between planning and aggressive planning

The time when tax advisers could indulge in a tasty "Double Irish Dutch sandwich" is over. Clients have probably not changed: they still call on their tax adviser to reduce their tax liability. But tax advisers have had to change because they were cast as the villains of the story. They used to be ethically and legally able to help their clients to deal with their tax affairs to any extent. They can still do so today, but under the shadow of legal penalties if their tax planning is branded as aggressive by the tax authorities.

The mandatory disclosure of cross-border tax arrangements by European intermediaries provided by the 25 May 2018 directive[4] will become effective on 1 July 2020. The whole system, sophisticated yet highly complex, has recently been implemented into French law (Government ruling (*Ordonnance*) no 2019-1068 of 22 October 2019). Tax advisers may face penalties (€ 5,000 for each unreported arrangement, capped to € 100,000 a year) alongside their client where an arrangement is considered aggressive by the tax authorities. This sets another example that lawmakers are keen to rely on ethics without clearly integrating the concept into law. As transactions initiated on or after 25 June 2018 will need to be reported by 31 August 2020, the analysis is made even trickier in the absence of local administrative guidelines (Let's hope those will be issued on time).

At the end of the day, tax advisers are left with the responsibility of determining the degree of morality that separates tax planning from aggressive tax planning. In so doing, they may face a breach of the attorney-client privilege which is the essence of their profession – rather unethical indeed.

[2] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market and Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries

[3] Council Directive (EU) 2016/1164 of 12 July 2016 – Article 6 : "For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part"

[4] Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements

Tax – a reputational and boardroom issue

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Tax planning has long been considered a duty towards shareholders. Nowadays, it triggers a reputational risk that companies must control at the highest level of their organisation.

Corporate citizenship

Although the concept of "corporate citizenship" is relatively old, its tax effects seem to have been neglected until recently. However, a steady stream of headlines in daily newspapers have changed the public mindset and have alerted public opinion to the importance of financial issues arising from the way some multinational companies are structured.

At the same time, the G20 has given a mandate to the Organisation for Economic Co-operation and Development (OECD) to launch a huge project to fight base erosion and profit shifting (BEPS), and a growing number of non-governmental organisations have started digging into tax matters and publishing their own assessments of the tax policies of some groups of companies.

Tax in the age of communication

The tax world is now in an age of instant communication, and economic players are starting to feel the consequences. Faced with the risk of falling share values following the publication of adverse news coverage of their tax behaviour, corporate groups are increasingly struggling to prevent criticism.

One answer is to publish tax codes of conduct – a practice that is now quite widespread in the US, in some Latin American countries and in Europe. However, this is probably only a first step towards a new era where companies will have to not just prove their compliance with human rights and their abstinence from aggressive tax planning, but also their commitment to live by an "ethical code" that takes into account the interests of developing countries, as well as developed countries' budgetary constraints.

Country-by-country reporting (CbCR) – which implies disclosure of the amount of taxes paid in the respective countries where a group is established – is already in place. Sooner or later, its content will become public in many countries, including Europe, where an EU directive is currently being discussed on the matter.

Tax risk disclosure is going to become "business as usual", with the development of accounting rules that make it compulsory.

A new vision of tax

This change is the sign of a profound evolution in the way contemporary society views taxes. Tax managers have long seen tax as a cost which, as any other cost, should be reduced in order to be fair to shareholders. Paying a low amount of tax used to mean that invested capital was properly managed and, in that sense, a low income tax bill was the proof of loyal and moral behaviour.

But the world has changed, and it is now widely accepted that companies should account for their tax management to many stakeholders – not just shareholders – and show that they pay their "fair share" of taxes. The concept of tax has ceased to be regarded primarily as a burden of economic activity and has (re) gained its political dimension, as a tribute to the state in its role as a supplier of public goods and policies.

To a certain extent, this evolution also shows the failure, or at least the inadequate nature, of classic tax policies which attempted to counter aggressive tax planning through specific anti-avoidance rules.

Many countries do have multiple sophisticated tax tools at the disposal of the tax authorities to fight, for instance, excessive interest deduction, hybrid entities, controlled foreign companies located in tax havens, and so on. This approach is evident in the current BEPS action plan developed by the OECD and in the EU directives on tax avoidance (ATAD). However, no measure is able to address the infinite array of possible structures that exist in the real world – which is why the global trend now is to establish general anti-avoidance rules which are "catch-all" tools bearing a high level of legal uncertainty.

Stigma

Against this background – where states feel to a certain extent powerless when facing sophisticated tax structures and are unable to a great extent to coordinate their efforts – it is clear that traditional legal and tax rules cannot respond to all the challenges of globalisation.

Hence the development of a new tool: stigma. Public shaming has been rediscovered as an efficient way of impacting corporate behaviour. When law is inefficient, shaming takes over, based on the assumption that consumer boycott is a more serious threat than administrative penalties to compel companies to adopt ethical tax policies.

Hence the development of the possibility for the tax authorities to publish the name and activities of corporate (and sometimes even individual) taxpayers which have been subject to high tax penalties following a tax audit. In many countries, tax is also becoming a criminal issue, as being subject to high tax penalties may lead a company directly to the criminal courts as well as the tax courts.

Criminalisation of tax law therefore goes together with the stigmatisation of "wrongdoers" in tax matters; it is a fundamental change in the tax environment.

Planning points

The outcome for companies is extremely clear: they should include in their "corporate governance" a layer of "tax governance".

All companies of a significant size should set up clear procedures to identify tax risks, define decision-making policies in tax matters and make sure that they are properly enforced.

Increased transparency towards tax administrations is clearly on its way. Many countries have developed compliance programmes that build on mutual trust between companies and tax authorities. It is probably in the interest of most economic actors to take them seriously; by not doing so, they would not even protect themselves against further disclosure obligations that will be enacted anyway.

It is worth noting that many states have already laid down such obligations in the field of aggressive tax planning and that a *European directive did the same last year. Many management policies will have to be reconsidered, from those that align managers' remuneration with tax performance to those that define the extent of reporting obligations from subsidiaries to the parent company of a group.

Will consumers in the next decade buy goods or services supplied by multinational companies only if they are labelled "tax-evasion free"? Like it or not, this may well happen. Because tax planning, and more generally corporate tax policies, must now be considered as a major reputational and boardroom issue.

* COUNCIL DIRECTIVE (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements

Ethical tax behaviour – a competitive business advantage?

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Dubious tax practices make good headlines. Recent examples include revelations about the Panama and Paradise Papers in leading newspapers including the Süddeutsche Zeitung, the cum-ex share trading practice, and structures for tax avoidance in Europe, in particular among US tech companies. Tax is prime time business news in Europe and the US. Can ethical tax behaviour give companies a competitive edge?

Status quo and low tax cost advantage

While the persons named in the Panama Papers and the companies involved often acted illegally, and the courts are still deciding whether the cum-ex deals are right or wrong, cross-border corporate law structures established to exploit different advantageous tax regimes are actually legitimate and are frequently used in practice.

And it's not just the US tech groups that are using these structures. Other well-established European companies – which are considered to be sound – "shift" their profit to countries in the EU and other jurisdictions where taxation is low. Even companies in which the State holds an interest are involved.

In highly competitive fields, such as the German maritime industry, this practice is understandable. Taxes are costs which either reduce the margin, or sometimes even make an offer so expensive that it is no longer competitive. Keeping costs as low as possible by keeping taxes low is also more attractive for shareholders.

There is a real disadvantage if competitors are located in territories where taxation is low. Companies from territories where taxation is high – such as Germany, France, Italy or the US – will try to compensate for this disadvantage. This is a purely economic approach based on current legislation, and it is legal.

Tax ethical conduct – a limited sales argument

At the same time, press reports have depicted many companies in a negative light for the general population, even though the companies involved have not broken the law. The problem, however, is that their approach to taxes contradicted their corporate social responsibility (CSR) obligations.

Consumers who can afford to use more expensive products and services are frequently willing to avoid certain companies because their CSR reputation is questionable. These consumers will no longer purchase from companies that do not meet their moral expectations. Ethical conduct can therefore also be a sales argument for B2C (business-to-consumer) companies.

For commercial purchasers, on the other hand, quality and price are usually the decisive factors – unless companies can use the ethical advantage with their own customers, and benefit from it.

Since private consumers increasingly base their buying behaviour on ethical sales arguments, the demand for fair trade products – chocolate, coffee and bananas to name a few – has increased significantly in recent years in comparison to traditional products. The proportion of products with eco-friendly features – such as electric cars – or those produced through eco-friendly manufacturing methods, including green electricity, is also growing. Some companies, including beer producers and internet search engines, promise to plant a tree for each case of beer purchased or for a certain number of search requests. This approach has been quite successful.

A key factor, then, in a company's purely economic assessment of the issue of whether to refrain from international tax avoidance structures, will be whether this argument can be used to convince buyers to purchase the product or view the company in a positive light.

However, the argument for behaving in an ethical tax manner does not appear to be as effective as environmental conservation and CSR. Approaches that focus on eco-friendly aspects or societal concerns are generally much more effective in the eye of the public.

The following considerations make this quite clear.

Good conduct can be harder to spot

Paying taxes is less visible than planting trees or protecting poor people from labour exploitation. The "good deed" is far more complex when it comes to taxes. Most people do not know enough about tax law and fail to understand what some companies do – or fail to do. The result is that most people have a very vague idea of "tax ethical conduct".

If a company says that it pays taxes in Germany, for instance, the general public cannot really verify that claim. It is simply not possible due to fiscal secrecy, and the sheer extent of the accounting documents. It would not be possible for individual consumers to check these documents, even if the company were to publish them and possibly reveal business secrets regarding sales and procurement markets. On the other hand, it is much easier to check whether trees have been planted.

One possibility would be to have a chartered accountant confirm that a company has refrained from tax avoidance activities. However, it should be borne in mind that in many cases the auditing firms have themselves advised the company on how to improve its tax burden.

Risks of advertising tax ethical behaviour

Any company that chooses to advertise by stating that it pays a lot of tax and does not use tricks to reduce or avoid taxes risks a public relations disaster. For example, transfer pricing entails considerable potential for dispute. An approach which may be well accepted in one country – because prices on intra-group transactions are advantageous for it by nature – may be disadvantageous to another country, and therefore cause harm.

There is hardly a safe approach in this respect. It will be possible at any time to find fault with the company for any price. A company can only break free from this catch-22 scenario by paying tax in two countries, i.e. accept double taxation. However, this cannot be the goal, economically or morally.

Getting the message across

Specialists or skilled workers – key stakeholders in a company who are not investors or consumers – are easier to reach with tax ethical behaviour. An employee or job applicant generally knows much more about the company in question than a consumer who is flooded with information. Employees and applicants are better able to understand the company's tax ethics as they have a greater interest in doing so. In today's increasingly competitive market for skilled workers this can be a key factor when job applicants are deciding whether or not to accept an offer. It also facilitates staff retention and loyalty. Who wants to admit that they work for an unethical company?

Good deeds sometimes make good news. While the press likes to report on the wrongdoing of companies, it also finds space for important corporate decisions that are made responsibly and ethically. Just like other ethically sound corporate decisions, the public welcomes tax ethical behaviour. If public relations gets involved, it is possible to attract positive public attention, placing the company in the news regularly. For example, if tax ethical behaviour is presented in the form of an information event for invited guests, it can also be leveraged for networking purposes with the goal of reaching specific stakeholders and not just the general public.

Tax avoidance structures – risky business

Using tax avoidance structures may carry disadvantages and can be risky. State tax authorities, which are also stakeholders in the company, cannot not be overlooked. They usually have instruments at their disposal which can hit commercial enterprises hard. Since the relationship with tax authorities spans the entire duration of the enterprise, it can be very difficult if problems arise.

As a rule, tax authorities do not condone tax avoidance. High transaction costs and administrative costs can result for companies if authorities feel there may be potential for a dispute in an international tax matter and seek disclosure in this respect. This can result in long tax audits, detailed and resource-intensive requests and

demands for documents, time-consuming lawsuits and a detailed review of minute issues by tax officials.

In addition to transaction costs, (aggressive) tax avoidance activities also frequently carry the legal risk of losing a lawsuit against tax authorities and not achieving the desired result with the structure chosen. Moreover, in practice there has been an increase in the number of criminal tax proceedings. On the one hand, legislation or case law forces tax officials to transfer the file to public prosecutors' offices where significant tax penalties are at stake; on the other hand, the tax authorities try to apply pressure on taxpayers and improve tax morale.

These risks can be significant, both financially and for the company's reputation, and they restrict the planning security often desired in the company, especially in the areas of finance and liquidity.

Planning points

In the end, the decision for or against tax ethical behaviour must be considered from a purely economic view in each individual case.

For companies that uphold and exercise social responsibility anyway, tax ethical behaviour is a must. It completes the picture of the company based on the general good, and therefore serves as an effective marketing tool. Anything else would damage its carefully developed image.

Companies that would like to address sensitive target groups should also seriously consider tax ethical behaviour as a sales argument. It is important that tax topics are handled very sensitively and, in the event of any doubt, the tax authorities are closely consulted for professional assistance.

As a part of branding, not as an advertising tool in itself – since tax ethics are not as visible as planting trees – tax ethical behaviour can definitely contribute to an economic and sustainable business strategy, developing strong stakeholder relationships, and gaining and retaining employees.

The quantifiable advantages – including a lower risk of litigation, costs and interest, as well as lower transaction costs and planning security – should not be underestimated.

Corporate criminal liability for tax evasion: a view from the UK, France and Italy

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There is an international trend to legislate for offences which seek to attach criminal liability to corporate entities where tax evasion or the facilitation of tax evasion has occurred. What are the key compliance implications for companies in the UK, France and Italy?

UK: New corporate criminal offences

Under the Criminal Finances Act 2017, two new corporate criminal offences were enacted: facilitating the evasion of (i) UK tax and (ii) foreign tax. The language of the new offences closely mirrors the offence under the Bribery Act 2010, where a corporate fails to prevent bribery on its behalf, but now applies the same concept to the facilitation of tax evasion.

The new offences are based on tax evasion by another person, not tax avoidance. Tax evasion occurs when individuals or businesses dishonestly omit, conceal or misrepresent information to reduce tax liability. Tax avoidance is not a criminal offence, but involves the exploitation of tax rules using transactions that are designed to gain a tax advantage.

Strict liability would attach to companies and partnerships ("relevant bodies") if they fail to prevent individuals or corporates acting on their behalf ("associated persons") from criminally facilitating tax evasion. The new offences can be committed irrespective of a gain accruing to a relevant body.

It is a defence to the new offences if relevant bodies can show they have "reasonable procedures" in place to prevent the facilitation of tax evasion by associated persons.

Planning points

What steps would a global corporate with a presence in the UK need to take?

The procedures should be developed following a risk assessment exercise to identify and address any risks relating to the facilitation of tax evasion. When assessing risk, a corporate must "sit at the desk" of its employees, agents and other associated persons and ask whether they have the motive, means and opportunity to criminally facilitate tax evasion and, if so, how this risk might be mitigated.

The procedures should be proportionate to the risk a corporate faces of its associated persons committing tax facilitation offenses.

The procedures should be developed with appropriate commitment from a corporate's senior management, which will be expected to take responsibility for the development and implementation of prevention measures. These should also make provision for appropriate due diligence, capable of identifying the risk of criminal facilitation of tax evasion by associated persons.

Consideration should be given to including due diligence when contracting with agents, consultants and business partners, and when recruiting new staff.

The procedures should be communicated and understood throughout the corporate, through internal and external communication, including training. Training should include, for example, a corporate's policies and procedures and an explanation of how and when to seek advice and report suspicions.

A corporate should monitor and review procedures periodically and make improvements where necessary.

France: Tax evasion offences

Under French law, corporates may be held criminally liable for tax fraud, alongside their legally appointed directors or their shadow directors.

Accomplices, whether individuals or corporations (e.g. a parent company), may also be prosecuted if they facilitate or instigate the commission of the offence. Accomplices incur the same penalties as the main perpetrators of the offence.

France does not have an equivalent to the UK's strict liability new offences.

Since October 2018, in addition to a fixed maximum fine, the penalty for tax fraud includes:
— for individuals – up to twice the amount of tax fraudulently avoided; or
— for corporates – up to ten times the amount of tax fraudulently avoided.

The general offence of tax fraud encompasses:
— fraudulently failing to file a tax return;
— fraudulently filing an inaccurate tax return; or
— using fraudulent means to avoid paying tax.

Higher penalties apply under certain circumstances such as when offshore bank accounts are used, artificial entities are interposed, or an offshore legal entity is established.

Apart from the general offence of tax fraud, there are other specific corporate tax offences such as the use of false accounting.

In practice, although the offence of tax fraud requires intention to be proved to the criminal standard, criminal liability of legally appointed directors is presumed, since they are treated as being responsible for a corporate's compliance with its tax and accounting obligations. Shadow directors may escape criminal liability if they have delegated their authority in relation to tax matters to a third party in certain circumstances.

Planning points

What steps would a global corporate with a presence in France need to take?

French law does not, strictly speaking, impose tax compliance obligations. However, it is best practice for corporates to implement tax compliance measures such as internal controls, policies and staff training.

Foreign corporates should be vigilant of French tax obligations. For example, if a foreign corporate avoids filing any French tax returns by way of having applied a regulation contained in a low tax jurisdiction, this could lead to a tax reassessment and could even result in criminal prosecution. This could be seen by the French tax authorities as a move designed solely for the purpose of avoiding tax.

Italy: tax evasion offences

A combination of criminal and administrative penalties applies when Italian tax legislation is contravened.

Criminal sanctions are typically imposed in cases of tax evasion, but can extend to other conduct not amounting to tax evasion, such as the concealment or destruction of accounting records. The most common tax evasion offences prosecuted are:

1. failure to file a tax return;
2. filing a fraudulent tax return; and
3. filing an inaccurate tax return.

Of the above, the most serious offence is 2., which is usually committed through the use of fake invoices (or invoices for fake transactions) and has no materiality threshold.

By contrast, 1. and 3. are subject to certain materiality thresholds, but these low thresholds are easily met by large corporates. For example, failure to file a tax return is almost automatically prosecuted when a tax audit results in a finding of an undisclosed permanent establishment of a foreign corporate, regardless of any fraudulent intent.

Similarly, the offence of filing an inaccurate tax return is triggered in any case of tax evasion above the materiality thresholds. Only a subjective intention and willingness to evade tax is necessary here. For example, this offence is often prosecuted following a tax audit of a multinational group.

Although a law was introduced in 2001 which imposes direct liability on corporates for certain specific criminal offenses, this does not currently extend to tax offences.

Currently, only individuals can be guilty of a tax offence, even if these individuals commit tax offences in their capacity as a director or employee of a corporate. Corporates are only subject to administrative penalties for breaches of tax legislation.

Planning points

What steps would a global corporate with a presence in Italy need to take?

Where a corporate can be held directly liable for specific criminal offences, the effective implementation of an organisational and management model aimed at preventing crimes is a defence.

Corporates are advised to implement an appropriate tax control framework (TCF) to minimize the risk of breaches of tax laws within the entity. The TCF has similar features to the organisational and management model. While this would not automatically exempt the individuals involved in the tax affairs of the corporate from criminal liability, it would certainly help to reduce the risk of tax crimes being committed.

The implementation of an effective TCF is also a necessary condition for corporates to access the cooperative compliance programme of the Italian tax administration. This programme, which is still in a pilot phase, is currently only open to taxpayers with an annual turnover higher than EUR 10bn (around USD 11.3bn). However, over time this programme is expected to be extended to other corporates with a lower turnover.

Joining the cooperative compliance programme does not automatically exempt a corporate from liability for contravention of tax legislation, but it would reduce the applicable administrative penalties. It may also help to mitigate the penalties where tax crimes have been committed by individuals involved in the tax affairs of the corporate.

Best practice focus: preparing for a tax investigation in Poland

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Getting your business ready to meet the requirements of an inspection by the tax authorities is vital for effective tax risk management. We outline best practice in Poland, and compare the requirements in Germany, the Czech Republic and Slovakia.

Tax investigations can make even a very cautious and meticulous financial director or chief accountant nervous. This is because the inconsistencies and ambiguities of tax laws make them one of the most common investment risks – especially in Central and Eastern Europe.

It is therefore very important to prepare properly for an investigation, even if you believe your business is not exposed. Relatively large transactions or transactions of an international nature tend to attract the attention of the tax authorities. What can be done to ensure a good night's sleep even when it's certain that tomorrow the tax authorities will be knocking on the door?

Even such certainty unfortunately is not guaranteed – in Poland some tax investigations may be conducted without notice. Customs and tax inspections (CTIs) are initiated only by the delivery of the authorisation of an inspection. Control activities may start immediately after delivery, which is often made in person by a tax inspector. This is because CTIs usually concentrate on tax and customs offences, frauds in value-added tax (VAT), VAT carousels and organised tax and customs crime, where it is necessary to act quickly.

On the other hand, ordinary tax controls (OTCs), which focus on all tax aspects of doing business, are usually announced in advance. OTCs cannot start sooner than seven days and later than 30 days from the delivery of a notice of the intended inspection. If an inspection is not commenced within 30 days from the delivery of a notice, another notice must be delivered in order to commence the inspection.

The situation is different in Germany, where a tax audit is announced in a formal letter with details of the location of the audit, the taxes and the period which will be audited, as well as the date when the audit begins. This, however, does not mean that the short period between receiving information about a tax audit and its start is enough time to prepare for the inspection. In both Poland and Germany, the best preparation is an ongoing approach that includes periodic analysis of certain areas of business activity.

Proactive preparation

Best practice in preparing for any type of tax audit includes careful consideration of the following aspects of your tax arrangements.

Identify risk areas and areas of interest

It is important to identify the key risk areas and areas of most interest to the tax authorities. In 2018, many inspections in Poland were initiated by the tax authorities based on a "unified control file" (UCF), introduced into the Polish VAT system in 2016. A UCF is submitted by each VAT taxpayer after the tax settlement period, and includes basic transaction data which were subject to VAT in a given settlement period. This data includes details of the names of the seller and buyer, transaction amounts, VAT amounts, transaction dates, the subject of the transaction, the tax rate, information on intra-Community deliveries and acquisitions, import, export or reverse charge transactions.

Additionally, in 2018 the Polish tax authorities were interested in businesses which showed tax losses in recent years. There was a particular focus on 2016, which saw a total amount of tax losses of PLN 55.4bn (USD 14.3bn), much higher than the PLN 40.8bn registered as tax losses in 2015.

Taxes such as corporate income tax, VAT and excise duty were priorities in 2018, and the Polish tax authorities were keen to inspect medium and large businesses rather than small and micro businesses. Transfer pricing, tax optimisation structures, intra-Community transactions and the reverse charge mechanism were subject to careful investigations.

In the Czech Republic the main triggers for tax inspections are reducing taxes, issuing fictitious invoices and overvaluation of invoices. It is also common for taxpayers deliberately not to present foreign assets or income in their tax returns. All these actions can trigger a tax inspection, especially after the introduction in 2016 of a control report (the VAT ledger), which all Czech VAT payers must file and where errors in data can be easily identified. In 2013, only 13% of tax inspections were in a digital form, and 22% of those resulted in an additional tax assessment. With the VAT ledger, this number is likely to increase – and this means some taxpayers may be audited without even knowing it.

Review tax settlements

It is wise to periodically review tax settlements and opt for extra tax analysis of unusual transactions as well as high-value transactions. Even if a transaction is closed, it is advisable to review recent tax and court interpretations issued in similar cases. Unfortunately, in tax cases the interpretation line often varies or changes unexpectedly, even if the tax law remains unchanged. This may influence past settlements and provoke tax investigations.

Consider securing future transactions

It is wise to consider securing future transactions that may contain tax risks by filing for individual interpretations. If some planned transactions are considered risky with respect to tax consequences, and at the same time the interpretation of tax law raises doubts, it is a good idea to file for an individual tax interpretation.

In some jurisdictions this kind of interpretation protects against additional tax liability or the initiation of criminal fiscal proceedings. This is the case in Poland and Germany. Individual tax interpretations are also available in the Czech Republic. However, unlike in Poland, in both the Czech Republic and Slovakia these interpretations are limited to transfer pricing and are in fact an equivalent of binding price agreements which are present in the Polish and other legal systems.

Establish formal procedures

Whereas tax compliance procedures are quite common, it is still rare for companies to have procedures in place in the event of tax inspections. Establishing formal procedures will reduce the stress connected with a tax inspection and will allow employees to act appropriately.

These procedures should indicate the employees responsible for supervision and direct contact with the tax authorities, as well as reporting rules. The procedure should also include the principles of providing documents and objects and making rooms available to tax inspectors, as well as the rules for preparing answers to the tax inspectors' queries. The procedure should be available to employees, who should be properly trained to apply it.

Tax authority effectiveness

Although the number of CTIs in Poland has fallen during recent years – in 2018, 3,000 CTIs were conducted, compared with three times that number in 2016 – the tax authorities are becoming more specialised and effective.[1] In the first half of 2018, customs and tax authorities conducted 1,700 CTIs, setting tax liabilities in the amount of PLN 6.4bn. In the same period of 2017, 2,633 inspections were completed, with findings amounting to PLN 7.44bn. As a result, the average amount of additional tax liabilities for one inspection amounted to PLN 3.55m in 2018, compared with PLN 2.82m in the same period a year earlier.

This improvement in the tax authority's effectiveness is also visible in their activities. In the first half of 2018, they carried out 10,361 OTCs. The amount of additional tax liabilities reached PLN 3.88bn. In the corresponding period of 2017, the authorities completed 13,854 inspections; the reported arrears amounted to PLN 3.21bn. The average cost of arrangements for one inspection in 2018 was PLN 375,000; in 2017, it was only PLN 143,000 – some PLN 232,000 less.

In comparison, according to the most recent full report published by the Czech Ministry of Finance (*Zpráva o činnosti Finanční správy ČR a Celní správy ČR za rok 2018)*,[2] in 2018 there was a total of 11,715 tax audits, with 7,032 (60%) completed with an additional tax liability. The total number of tax audits decreased by 16.1% in comparison to 2017. The financial administration focused on various areas, such as VAT deficiencies in cases of fictitious services (agency employment, advertising services) and fictitious documents and transactions.

Planning point

The Polish tax authorities have become much more knowledgeable and qualified in certain areas of taxation. Tax inspections are frequently preceded by in-depth analyses.

Meticulous preparation for a tax inspection, which includes the implementation of all the above points, may significantly reduce the risk of fiscal and criminal responsibility and may secure a good night's sleep – even if a tax inspector knocks on the door.

1 https://www.ey.com/pl/pl/services/tax/business-tax/raport-bezpieczny-podatnik

2 https://www.mfcr.cz/cs/verejny-sektor/dane/danove-a-celni-statistiky/zpravy-o-cinnosti-financni-a-celni-sprav/2018/zprava-o-cinnosti-financni-spravy-cr-a-c-35633

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