

IRS Oversight Board: Corporate Board Governance of Tax Risk

February 3, 2010

On February 3, 2010, TEI President Neil D. Traubenberg participated in a panel on corporate board governance of tax risk before the IRS Oversight Board. Mr. Traubenberg's written statement is below. Mary L. Fahey, TEI General Counsel, served as legal staff liaison on this project.

Good afternoon. I am Neil Traubenberg, Vice President for Corporate Taxes for Sun Microsystems, located in Broomfield, Colorado. I am here today as president of Tax Executives Institute. As the preeminent association of business tax professionals, TEI is pleased to submit this statement in conjunction with the February 3, 2010, public meeting of the IRS Oversight Board.

Background

Tax Executives Institute was established in 1944 to serve the professional needs of in-house tax practitioners. Today, the Institute has 54 chapters in the United States, Canada, Europe, and Asia. Our 7,000 members are accountants, attorneys, and other business professionals who work for 3,000 of the leading global companies; they are responsible for conducting the tax affairs of their companies and ensuring their compliance with the tax laws. TEI represents the business community as a whole, and our members deal with the tax code in all its complexity, as well as with the Internal Revenue Service, on almost a daily basis. Most of our members, for example, work for companies that are part of the IRS's coordinated industry case (CIC) program, and thus are under continual examination by the IRS's Large and Mid-Size Business Division. TEI is dedicated to the development and effective implementation of sound tax policy, to promoting the uniform and equitable enforcement of the tax laws, and to reducing the cost and burden of administration and compliance to the benefit of taxpayers and government alike. We are proud of our record of working with our members and with governmental authorities, including the IRS and the Organisation for Economic

Co-operation and Development, to develop best practices and to otherwise improve the tax administration process.

TEI is pleased to provide information on corporate governance and tax risk management, including a discussion of the various factors that have led us to this point, the complexity of some of the issues suggested for review by a company's board of directors, and the mechanisms by which the board may undertake its fiduciary obligations.

Discussion

Discussion of corporate board governance and tax risk seems to be everywhere recently. According to the OECD, corporate governance "deals with the rights and responsibilities of a business's board, senior executives, management and employees, shareholders and other stakeholders." Good corporate governance "is essential for businesses that want access to capital and for governments that want to stimulate private sector investment." On the other hand, poor corporate governance "weakens a business's potential and at worst can pave the way for financial difficulties and even fraud."¹

Managing tax risk can have a significant effect on a company's financial performance and reputation. In a March 19, 2007, speech to TEI, Jeffrey Owens, Director of the OECD Centre for Tax Policy and Administration, emphasized:

Tax has ceased to be something that just interests tax directors. The press is taking an increasing interest in tax issues. Newspapers such as the *Financial Times* and the *Wall Street Journal* now run front page headlines on the way some companies have been targeted

over tax avoidance, the intention of a company to shift its headquarters offshore.

More recently, IRS Commissioner Douglas Shulman addressed the topic. In an October 19, 2009, speech to the National Association of Corporate Directors, the Commissioner urged boards of directors to reassess "their roles and responsibilities in conducting appropriate assessment and oversight of tax risk." He offered the following examples:

- Setting a threshold confidence level for taking a tax position;
- Discouraging or eliminating opinion shopping by tax departments by having an independent tax firm, which has some direct dialogue with the board of directors, review major tax positions; and
- Specifically addressing transfer pricing and the relative profit allocated to low-tax jurisdictions, and making sure they reflect real economic contributions made in those jurisdictions.

The Commissioner's remarks are evidence of the growing global trend toward more active engagement by tax administrators to understand the tax risk management policies of their largest taxpayers.² The IRS's initiative has been interpreted by some commentators, however, as suggesting that corporate tax directors — the employees charged with day-to-day management of a company's tax affairs and, hence, its tax risk — need more operational oversight. Indeed, some TEI members have voiced concern that, to date, the "conversation" has perhaps lent too little weight to

the professionalism of the corporate employees charged with responsibility for ensuring compliance and to how much time and effort those employees — and their superiors in corporate management — are already devoting to assessing and managing tax risk.

Stated differently, the “conversation” about tax risk and the internal controls over financial statement reporting has been going on for some time, spurred not only by the enactment of the Sarbanes-Oxley Act in 2002, but by the Financial Accounting Standards Board’s issuance of FIN 48 relating to how “uncertain tax positions” are reflected on a company’s financial statements³ — and, candidly, by the enforcement thrusts of the IRS for the past several years.

In his October remarks, the Commissioner cited transfer pricing issues as an example of an issue in which the Board should engage. In our experience, that is already occurring: Significant transfer pricing issues have been included on the agenda of the meetings of my company audit committee — and, I dare say, those at most other major companies — for several years. At the same time, many commentators have questioned how detailed a review can take place given the overwhelming complexity of the governing law and the general lack of tax expertise among board members.⁴

TEI believes it is important for governmental authorities to recognize that, as a whole, companies are striving to “get it right” and are devoting considerable time and effort to doing so. Not only is tax risk discussed at audit committee meetings, but other procedures or techniques are routinely used by TEI members to keep upper management well informed and to both manage and minimize tax risk. For example, many companies have policies that require a transaction to meet a certain authority standard before it is undertaken. Larger companies may have a finance committee composed of directors with significant financial expertise to evaluate complex financial and business transactions, including tax risk. Finally, some tax departments may be subject to an Enterprise Risk Management (ERM) review as part of their company’s annual efforts to comprehensively identify business, operational, and financial risk within an organization.

In TEI’s view, the key is not for the board to get “into the trenches,” but rather — given the importance of taxes as a cost of doing business — for the board to have a mechanism in place (supported by adequate resources) to oversee tax risk as part of its governance process.⁵

The obligation is not only that of the taxpayer. The OECD recommends that tax administrators collaborate with relevant associations and institutes and engage in active communication with large businesses, intermediaries, accounting, industry, and law associations to increase business awareness of the government’s compliance strategies, activities, and perceived risks.⁶ Commentators have agreed:

We believe it is appropriate for corporate governance principles to be at the heart of the debate on tax. There need to be checks and balances on the behavior of both tax authorities and corporate taxpayers, built into their operating guidelines. Clearly, the law must be the ultimate arbiter of what is correct, but we have seen that good behaviors can go beyond the minimum requirements of the law and can help assuage the needs and concerns of both sides.

The U.S. needs to find its own way on this road, but it can take valuable lessons from the experiments going on elsewhere in the world. *The first and most fundamental of these is that at the heart of a changed model are better relationships, and these new relationships can only develop with better dialogue. Talking is always the first step, and [Commissioner] Shulman is encouraging more people to take that step.*⁷

TEI agrees that communication is key, not only between the tax department personnel and upper management, but between companies and their government counterparts. Since its founding in 1944, TEI has worked with the government on many initiatives to enhance tax administration. For example, seven years ago, TEI and LMSB representatives worked together to create the joint audit planning process, which had the goal of enhancing accountability and efficiency by having the IRS and the taxpayer execute a

jointly developed, issue-focused audit plan. Regrettably, implementation of the process across the taxpayer community and within LMSB was uneven, and we are pleased that LMSB is committed to re-invigorating this process.

In addition, the IRS already has programs in place — such as the Compliance Assurance Process (CAP), Limited Issue Focused Examination (LIFE), and Advance Pricing Agreements (APAs) — that help provide greater certainty — which is beneficial to both government and taxpayers. Tax administrations “look for certainty around voluntary compliance with tax laws and taxpayers having good governance arrangements in place. Taxpayers look for certainty about which of their behaviors and transactions the tax administration is likely to see as risky, and how the administration is likely to respond to those risks.”⁸

Thus, the issue now is not whether corporate boards will inquire about tax risk, but when, how often, and how extensively. As the OECD found —

Leading practice boards in many countries are mandating that tax risk be managed like any other enterprise risk. Recent international surveys by major accounting firms indicate that tax risk management is increasingly gaining acceptance at board level. Findings include that senior executives are increasingly looking for better insights into tax because of its potential material impact on financial statements and that the tax function can no longer focus solely on tax compliance and managing the effective tax rate. CEOs and boards are asking more complex questions about how their organisation manages its tax risk exposure.⁹

There is a need to develop “enhanced relationships” between tax administrations and taxpayers, which will benefit both sides:

An enhanced relationship offers benefits for revenue bodies as well as taxpayers ... taxpayers who behave transparently can expect greater certainty and an earlier resolution of tax issues with less extensive audits and lower compliance costs. An enhanced rela-

tionship between revenue bodies and tax intermediaries would also yield significant benefits.¹⁰ TEI looks forward to continuing the dialogue with the IRS on this initiative and we pledge our ongoing commitment to effective and efficient tax administration.

CONCLUSION

Tax Executives Institute commends the IRS Oversight Board for holding this public hearing. TEI looks forward to working with the Board and the IRS itself to improve tax administration.

1. OECD Forum on Tax Administration, *Information Note: General Administrative Principles: Corporate governance and tax risk management*, ¶¶ 14 & 15, at 6 (July 2009) (citations omitted) (hereinafter cited as “OECD Corporate Governance Principles”).
2. Kelly, Shaun, & Loughlin Hickey, *An International Perspective on Tax Risk* (Dec. 1, 2009), published online at <http://www.directorship.com/an-international-perspective-on-tax-risk/> (hereinafter cited as “Kelly & Hickey”).
3. The FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, on December 16, 2006. The interpretation is now codified in *FASB Accounting Standards Codification* 740.
4. Courts continually struggle with transfer pricing cases. See, e.g., *Xilinx, Inc. v. Commissioner*, 562 F.3d 482 (9th Cir. 2009), where the Tax Court found in favor of the taxpayer concerning the inclusion of stock options in its cost sharing arrangements. The court of appeals reversed in a 2-1 opinion that was subsequently withdrawn. The case is still pending.
5. As an association of in-house tax officials, it may seem self-serving for TEI to state that responsibility for managing tax risks should reside with Chief Tax Officers and their staffs, but for 66 years the Institute has been devoted to enhancing the professionalism of the tax department and thereby discharging our duty as corporate employees and members of the tax profession to effectively manage our companies’ tax affairs. Thus, it is not at all a surprise to the Institute that a recent survey of corporate tax directors demonstrated that nearly 80 percent reported that their company “already has an established mechanism in place to oversee corporate tax risk as part of their corporate governance process.” Klotsche, John, Neil Trautenberg & Tracy Hollingsworth, *Tax Risk Management: Shulman’s Conversation with the Board*, Special Report, TAX NOTES 193 (Jan. 11, 2010).
6. OECD Corporate Governance Principles at ¶ 46, at 11.
7. Kelly & Hickey (emphasis added).
8. OECD Corporate Governance Principles at ¶ 30, at 8.
9. OECD Corporate Governance Principles at ¶ 26, at 7 (citation omitted).
10. OECD Corporate Governance Principles ¶ 29, at 8 (quoting the *OECD Forum on Tax Administration Cape Town Communiqué January 2008*).