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Responsible Taxation

Evaluating the benefits of tax transparency reporting to Nigerian businesses in changing times.

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KPMG in Nigeria

SBIA Scaling Business in Africa
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Contents

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Introduction and overview

Tax is the price we pay to achieve a civilized society, provide for roads, schools, hospitals, social programs, and other critical infrastructure. With Environmental, Social and Corporate Governance (ESG) now at the top of the leadership agenda, tax has an important role to play, and decisions in this space can have a profound impact on the world of tax.

From Government tax measures in place to reward or remediate behaviors, to the impact organizations' tax affairs now have on their reputation and bottom line, a socially responsible approach to tax is increasingly important to organizations and the way they do business. It is not only the right thing to do for society; it is also a driver for sustainable growth[1].

There has been a lot of talks globally, around responsible tax and the role of corporate citizens towards contributing their fair share to the societies where they operate through the taxes they pay. The structure and operations of companies today are very different from what they were a few decades ago. It is now possible to operate and earn profit from a particular jurisdiction without a physical structure, using predominantly digital and intermediary platforms. This has made the establishment of a framework under which the contribution of these companies to the societies from where they earn their revenue can be reported more important than ever.

There is also growing interest amongst investors to understand how companies in their portfolios approach tax-related issues. As multinational companies continue to face increased scrutiny in relation to their tax practices, investors are demanding greater transparency to evaluate companies' exposure to potential earnings, governance, reputational and broader societal and macroeconomic risks.

In general terms, where corporate disclosure is poor, investors may engage with companies to encourage improvements in their publication of tax-related qualitative and quantitative information to aid investment decision-making. With the significant pressure on executives to deliver record profits while countries are also in competition to attract investments and create opportunities for their population, it has become imperative for companies to maintain transparency and responsibility in their transactions to the general public and their respective stakeholders. Further, there is an increased demand for companies to not only contribute their part but take proactive steps to tell their story in terms of their tax contribution and its impact on the societies in which they operate.

Tax transparency and responsible taxation could mean different things to different organisations and people. It can be viewed as a spectrum. What is deemed 'enough' by the business, the public, investors, and Governments, will change over time. Likely, "the norm" will move along the spectrum so that more disclosure is necessary. However, in general terms, tax transparency is an approach to tax that is open, developmental, and considers the interests of all stakeholders both within and outside of an organisation[2].

The African Union global forum on transparency and exchange of information for tax purposes estimates that Africa loses about 40 – 80 billion United States dollars (USD) in tax evasion on an annual basis[(3)]. This creates a huge gap in revenue generation for Governments and consequently, reduces the resources available to implement developmental initiatives and create additional opportunities for investors into their countries.

In 2014, the African members of the above-mentioned global forum comprising 32 member countries, including Nigeria, created the African Initiative on Transparency and Exchange of Information for tax purposes. The objective of the initiative was to unlock the potential for tax transparency and exchange of information in Africa to battle tax evasion and ensure that African countries are well-positioned to benefit from the improvements in global transparency[3]. The question however is, how successful has this initiative been? Can we say that we have seen increased transparency in tax reporting in the continent and subsequently, its impact on tax collected and overall development of African societies?

Why is corporate tax transparency important?

Tax has, in recent times, become an issue of reputation and corporate governance. External stakeholders such as the media, civil society organisations, Government, investors and the public at large are showing an interest in a company's tax affairs including its strategy, and the amount of tax that it pays.

Tax transparency is often a key metric when demonstrating a responsible attitude towards tax. There are four (4) key arguments that enhance corporate tax transparency as a key business issue, which affects the way external stakeholders view a company's corporate reputation.

- **The amount of tax a company pays is material to its profitability.**

  Therefore, external stakeholders, especially investors, need to understand the extent to which future cash flows are based on the performance of the underlying business, and the extent to which they rely on other factors such as access to subsidies and the use of artificial tax structures, which may be challenged in the future.

- **Corporate tax avoidance activities may suggest underlying legal, operational, reputational, financial and/or governance risks.**

  Investors increasingly recognise that companies that pursue structures that aggressively minimise their tax activities may be sending a signal regarding the board's or management team's risk tolerance. High risk tolerance can create a variety of damaging outcomes for the business. For example, where boards are focused on short-term tax-related strategies and gains, opportunities linked to genuine economic activity may be overlooked. Therefore, it is important that investors can access corporate information that provides a wholistic view of a company's governance of tax-related issues.

- **Investors want reassurance that the tax practices of their portfolio companies can withstand stakeholder scrutiny and potential regulatory changes.**

  As corporate tax regimes are reconsidered across countries to avoid revenue loss due to tax avoidance, multinational companies face increased pressure to defend their tax-related transactions and/or may see new forms of taxation applied. Therefore, a corporate reporting that shows how the corporate tax structure and strategy are implemented in light of regulatory environment as well as tax contributions to the operating environment will boost investor confidence.

- **Investors recognise that corporate taxes support society's tangible (i.e. infrastructure) and intangible (i.e. education, governance/legal, etc.) needs.**

  Investors understand that strong Government institutions create a solid foundation for competition, growth and other factors that enable long-term business sustainability at investee companies. Therefore, corporate income taxes are an important part of most Government's revenue base, and thus, would want to help to support it.

Practical implementation of tax transparency reporting

Tax touches all the United Nations Sustainable Development Goals and has huge potential to affect how communities thrive and prosper. Reporting on tax is not only about being transparent or about how much tax you pay, it is about the principles applied and the impact your tax footprint makes, and actively demonstrating the impact your business is making on achieving sustainable and inclusive growth.

There have been several initiatives launched at the continental level to ensure tax transparency reporting. These initiatives mainly focus on mitigating incidences of tax evasion through automatic exchange of information, exchange of information on request, tax information exchange agreement, effective tax rate benchmarking and country-by-country reporting for multinationals.

However, there is no local framework that requires mandatory tax reporting by companies operating in various jurisdictions. Even the initiatives promoted by the various African countries are only tailored towards income reporting rather than tax reporting which would show the various tax contributions of companies and enhance tax transparency. Corporate income tax-related information published by companies appeared to be largely focused on meeting regulatory requirements rather than stakeholder demand. This driver is reflected in the type of information and the level of details published by companies.

We have highlighted below some of these initiatives as follows:

- **South Africa**

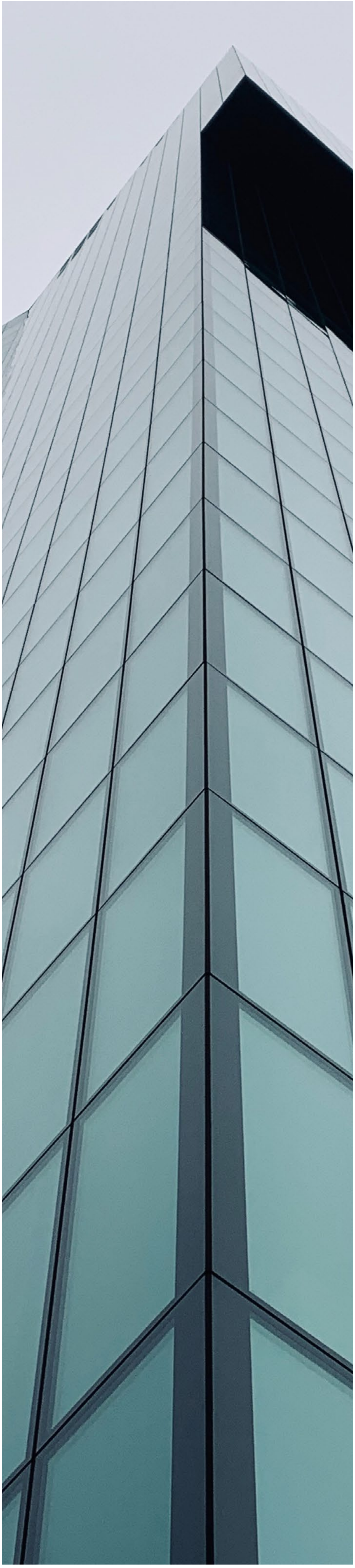
  The South African Revenue Service launched the Special Voluntary Disclosure Programme (SVDP) which ran from 1 October 2016 through to 31 August 2017. The SVDP provided an avenue for taxpayers to voluntarily disclose assets and income streams held offshore. In other to incentivise compliance, the SDVP provided exemptions from income tax, donations tax and estate duty liabilities from the past assets and income reported by participating companies[4]. Based on the tax transparency in Africa report, the Programme contributed USD1.8 billion in foreign assets and resulted in revenue to tax authorities of about USD296 million[3].

  However, not all companies participated due to non-mandatory requirements for the Programme. It is safe to assume that only companies who would benefit from the incentive participated in the scheme.

- **Nigeria**

  Nigeria has also developed a few initiatives/ programmes aimed at promoting voluntary tax compliance amongst large organisations and high net worth individuals, such as the Voluntary Assets and Income Declaration Scheme (VAIDS) and the Voluntary Offshore Assets Regularisation Scheme (VOARS).

  Again, the jury is out as to how successful these Schemes have been and whether they have encouraged more transparency from taxpayers. Furthermore, the Schemes were one-off, and time-bound and so, do not contribute to a process of continuous voluntary disclosures.



An omnibus model for Nigeria and developing countries to improve

Although the Nigerian Government has taken significant and applaudable steps towards responsible taxation and the utilization of tax as a tool for companies to show responsibility towards their society, the schemes need to be well structured, moderated, and transparent to allow for some uniformity and ease of tracking.

Presently, Nigeria has deficits in infrastructure across various sectors including health care, education, power, affordable housing, and transportation. These are sectors which primarily benefit the ordinary Nigerian citizen and should be major focus areas for development for the Government. Therefore, an incentive scheme targeted at these areas will pave way for sustained and advanced developmental opportunities across other sectors in the country and benefit the Nigerian Government and the people at large.

It may therefore be necessary for the Government to enact legislation that mandates minimum tax reporting requirements. The current scenario where only income tax paid in any given year is disclosed in the audited financial statement may no longer be sustainable. Companies operating in the country should disclose information on the total amount of taxes and contributions made to the various revenue collecting agencies in the country and how it compares to other financial indices. Stakeholders should be able to pick up a company's financial statement and see immediately how it interacts with the society where they operate and how it compares with similar companies in their sectors of operations.

Linking tax contributions to specific infrastructure development schemes akin to what is in place with the Road Infrastructure Development and Refurbishment Investment Tax Credit Scheme (RIDRICTS) in Nigeria today.

Government can also further incentivise responsible tax behaviour by commissioning an annual review of the information provided by the companies led by the private sector to evaluate this information and create a ranking system that seeks to show the perception of how much each company does in response to the amount of revenue generated in each area.

Potential challenges and benefits to all parties (companies, Government, and citizens)

Governments in Africa and Nigeria especially have continued to lament about the poor rate of contribution of tax to their overall revenues. However, there has always been a lack of clarity as to why this is the case. Do multinationals operating on the continent pay their fair share, or is the issue a lack of structure to tax the opaque but large informal sector, which constitutes a significantly large part of the economy of most African States? There is obviously a paucity of information which a tax transparency framework would seek to resolve.

It is therefore in the interest of Governments across the continent to ensure the establishment of such a framework. Africa also has a bludgeoning middle class whose taste and demand for goods and services made in the West continue to grow. However, it is difficult to determine if these companies, which earn revenue from the wants of the continent, contribute anything to the development of the region through the payment of appropriate taxes. And if they do, how does it compare to the amount of revenues they generate from the continent. A tax transparency framework, which contains minimum disclosure requirements, would address this issue.

There has also been talk over time about the cost of enforcement of tax laws in Nigeria and African countries. It is not economically feasible to effectively enforce tax compliance. Therefore, it is important for the Government to evolve ways of channeling limited resources to ensure improved collection and compliance. The publication of a tax transparency report would contribute to this effort. Government can at a glance identify outliers based on information available and focus compliance initiatives on these outliers.

The benefits though are not limited to only Government. The link to infrastructural development will surely improve operational capacity of these companies and by extension their profitability.

Furthermore, companies who have always argued that they are overtaxed with minimal benefits can now show this fact clearly. It has always been argued that though tax contribution to GDP in Nigeria is low, the number of entities, which contribute these amounts compared to the total number of players in the country maybe even lower. We may have consistently placed more and more burden on the same set of taxpayers rather than focusing on expanding the net.

A lot of companies also may not have an overview of the amount of taxes they pay on an annual basis and how it compares to their other cost profiles. Tax is typically embedded in the cost of several items and across several expense accounts that top management of companies do not necessarily have insights into how much they pay and for what taxes and levies other than the income tax which is a line item in the audited financial statement. The publication of this information would provide management with tools to make informed decisions. This does not even consider the increase in the reputation and goodwill of the participating organisations and public acceptance.

On the flip side, a major challenge, which may be faced by the scheme would be the accountability and transparency of the organisation though this can easily be addressed by ensuring that reputable auditing firms assure the numbers before they can be disclosed.

However, from a broader tax accountability and transparency perspective, one way to raise corporate tax morale is for any Government to be seen as transparent and accountable. Citizens need to know how tax money is used and spent. They need to feel the dividends of tax. In other words, tax needs to pay! Oftentimes, tax accountability is the missing part of the jigsaw.

A recent study on taxation in Nigeria[5] concluded that citizens have a very poor perception of the Government in relation to tax accountability. It is like pouring money into a bottomless pit. They often argue that they pay taxes and are still their own "local Governments" – i.e. they still provide those amenities their taxes should have provided for them if well spent. Some argue that the Government cannot be trusted with more money until the Government is able to make better use of existing revenues.

Unfortunately, the lack of trust due to low tax accountability will continue to impede and undermine tax compliance if not addressed. Perhaps, it is time to institutionalise tax accountability in Nigeria. The Federal Inland Revenue Service (Establishment) Act, for instance, only mandates it to raise tax revenues. Beyond that, it cannot account for how tax revenues are used. The Government may want to set up a tax accountability desk that will be in charge of communicating and publicising how tax revenues are utilised.

The other suggestion is for tax revenues to be earmarked for development goals. For instance, the Government can have a 10-year plan where one of the Sustainable Development Goals (SDGs) could be identified a year ahead as the target of the following year's tax revenues. Where and when these commitments are fulfilled over the suggested period, it would be a very good way to build trust and restore the social contract between citizens (especially corporates) and the Government.

Conclusion and way forward

Overall, responsible taxation is a major area which needs to be further explored and better structured to position organisations for better access to communities through developmental projects that directly profit the local communities as well as provide tax benefit incentives to the organisations.

The proposed model for Nigeria provides an extensive opportunity for the rehabilitation of numerous sectors integral to the progress of the Nigerian economy without extensive input or manpower from the Government. This will also provide the Government with an opportunity to devote resources to more pressing areas of governance, leading to an overall improvement in the livelihood of Nigerians.

For investors looking to engage in tax transparency, a starting point could be to check for a publicly available tax policy. Where companies are yet to publish a policy, the model should encourage investors to query if there are any barriers to publishing tax principles and existing tax governance and control processes, communicate to portfolio companies about what kind of information is relevant and useful in a tax policy, and refer to good practice examples of tax policies from peer companies.

For companies, the proposed model provides an avenue for a public-private-sector partnership to develop critical infrastructures that will improve their business operations, expand opportunities, improve the relationship with host communities and public perception.

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