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Board Matters Quarterly

Board Matters Quarterly offers thought-provoking perspectives and insights into leadership and governance issues for boards and audit committees, providing support to navigate an increasingly complex business environment.

How the future of tax is redefining business operations

How boards can drive resilience in today's zoo of risks

How the future of Tax is redefining business operations

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The taxation landscape and the attitude towards dealing with taxation have evolved tremendously in recent years. A decade ago, unless a major tax bill arrived, the general perception of senior management was that tax was a compliance exercise. Tax was an afterthought then and may not have featured much, if at all, in decision-making. Tax implications may not have been addressed upfront but instead managed as and when an issue arose. Today's world is very different. Tax news feature prominently in the business sections of newspapers, tax changes in the national budget announcement are eagerly awaited and carefully analyzed, and a seemingly unending series of changes to the global and domestic tax landscapes has made it extremely challenging to predict future taxation trends.

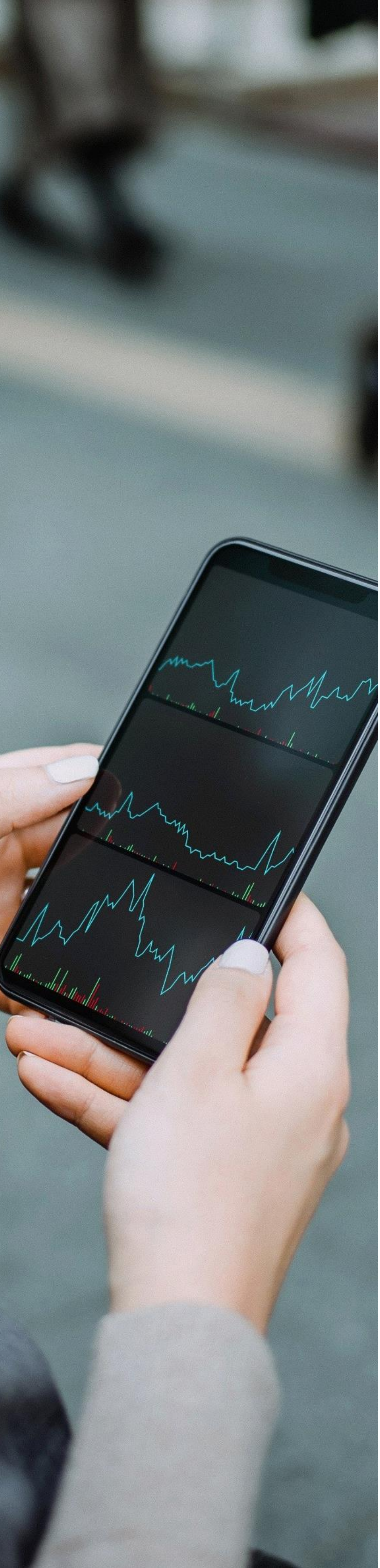
When it comes to taxation, some of the key challenges faced in today's world are:

1 Speed of change of tax rules and regulations

2 Global tax reform

3 Tax and technology

4 Fiscal policy and pressure to collect revenue and change behaviour



1 Speed of change of tax rules and regulations

Respondents to the 2021 EY Tax Risk and Controversy Survey said that the pace and volume of tax change are relentless, with digitalization disrupting the decades-old tax compliance life cycle. This has created a far more diverse tax risk environment. In any given month (or sometimes even every week), new rules and regulations are being introduced on taxation matters or existing rules are revised, and it is important for businesses to keep up to date. Implications to the business need to be identified and analyzed quickly, even before the rules and regulations come into force, to ensure that the company is nimble enough to address the change and manage tax issues upfront, to avoid impacting business operations. This does not only mean addressing potential tax costs. Tax-driven changes to documentation, systems and reporting requirements can significantly impact operations if not properly managed.

2 Global tax reform

International organizations such as the Organisation for Economic Co-operation and Development (OECD) are developing complex rules to curb aggressive tax planning and influence changes to domestic tax laws. One example is the global minimum tax rules designed by the OECD, which will be implemented in many countries in 2024 and in countries such as Malaysia, Singapore, Hong Kong and Thailand in 2025. Another example are the recent and proposed changes in Malaysia, Singapore and Hong Kong in relation to the taxation of foreign sourced income and gains, which were driven by the requirements of the European Union.

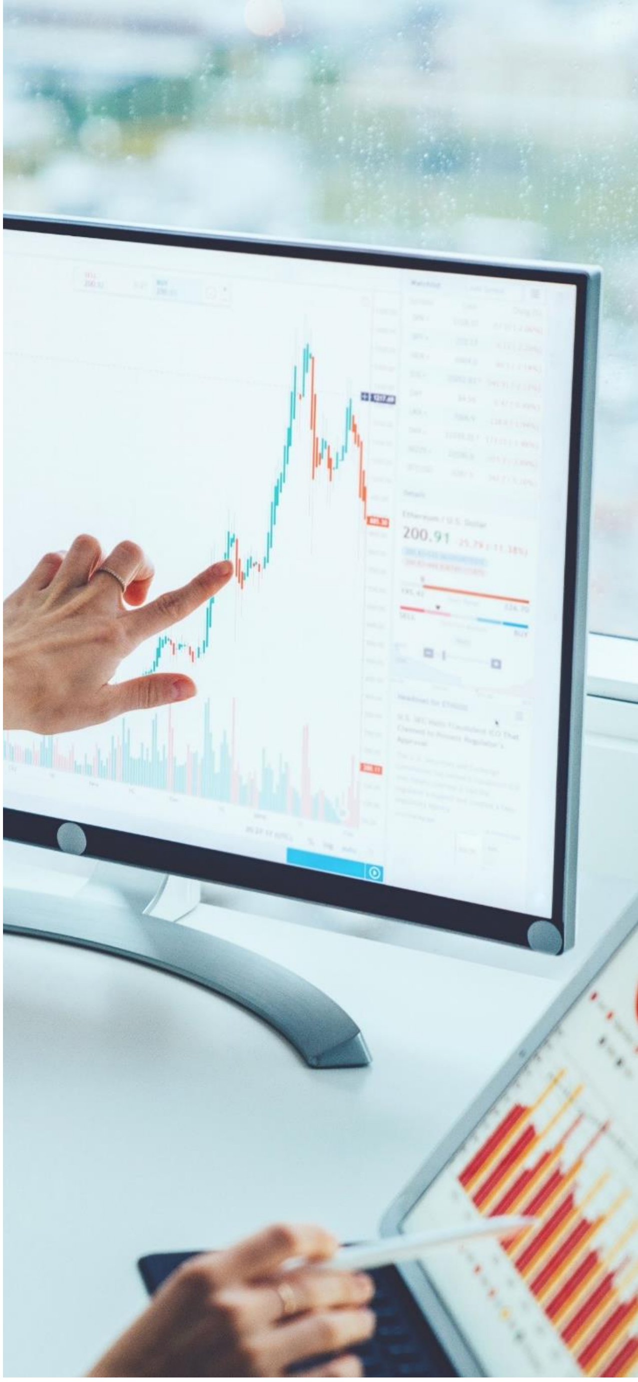
The move towards tax transparency has led to an increased and seamless exchange of taxpayer information between countries. Multinational businesses need to comply with global requirements and standards such as country-by-country reporting. They must also anticipate and prepare for the questions that the tax authorities may ask as a result of the vast amounts of information that is now available to them.

3 Tax and technology

Digital transformation is pushing the boundaries on taxation, impacting not just taxpayers but tax authorities as well. Tax authorities are equipping themselves with the latest digital skills to facilitate their collection, audit and enforcement efforts, and are now hiring as many data analysts and scientists as there are accountants and lawyers. This is crucial because initiatives such as the exchange of information and e-invoicing will result in significantly more data being received by the tax authorities at a faster pace than ever before, and the value of this data will not be maximized without proper analysis.

With tax authorities becoming increasingly sophisticated and technologically advanced, taxpayer behaviour must also adapt. Businesses need to be ready to embrace technology and digitalize their business processes. The future of taxation is digital, with real-time scrutiny on the tax treatment of transactions. This means businesses need to be agile and move quickly, otherwise unwanted tax risks will materialize and become threats to business operations. Furthermore, the increased complexity of tax compliance and the requirement to comply with initiatives such as electronic filing and e-invoicing means that doing things manually is no longer an option.

Tax technology is not just about hardware and software – the importance of the people factor cannot be underestimated and there is a need to diversify the skillsets of the tax team. With the digitalization of the tax function, there is a need to ensure employees are trained to be competent in this new environment and able to perform their duties using new tools and technology. This requires a significant change in mindset as well as approaches to recruitment, as businesses compete for employees who are not just tax savvy but also trained in tax technology.



4 Fiscal policy and pressure to collect revenue and change behaviour

Governments are increasingly using tax policies as a means to increase national revenue and create a more sustainable and inclusive economy and society.

This includes the use of incentives and reliefs or new types of taxes or levies, to encourage behavioral changes. Examples of this include green incentives to encourage certain types of behavior and carbon taxes to curtail negative behavior.

Tax incentives are a powerful fiscal tool, but they must be designed such that they are relevant to the industry sectors being promoted, benefit the nation, support domestic industries and increase the nation's competitiveness on the regional and global stage. Incentives should be regularly reviewed to ensure that they continue to meet the desired objectives.

All this will improve the economy and the spillover effects will result in better revenue collections.

2 How boards can drive resilience in today's zoo of risks

From black swans to gray rhinos, the risk universe today is expansive, complex and interconnected.

Black swan events – or unknown unknowns – are potentially catastrophic events that are rare, impossible to predict and outside our control. More plentiful and expected, gray rhinos – or the known unknowns – often charge at us in plain sight with a significantly wide impact. Boards should prioritize the latter and think more proactively about it in enterprise risk management.

Amid the usual suspects of financial, cybersecurity, reputation, compliance and competitive risks, companies are also facing increased pressure to deal with risks relating to climate change and sustainability, the supply chain and global geopolitics in recent years. The burden on boards and emphasis on governance have also increased accordingly.

According to the EY 2023 Global Board Risk Survey, which surveyed 500 global board directors from organizations with revenues of over US$1b, less than a quarter of the boards covered are considered highly resilient.

Highly resilient boards are confident and respond to unexpected high-impact incidents better. They are more likely to be highly effective in aligning risk and business strategy. Far from being complacent, these boards are cautious about gaps in their preparedness and aware of the evolving nature of the risks they face. By focusing on the following key areas, boards can better support their organizations in prioritizing resilience.

> Cautious about gaps in their preparedness and aware of the evolving nature of risks, highly resilient boards are more likely to be highly effective in aligning risk and business strategy and better respond to unexpected high-impact incidents.

Anticipate emerging and material risks

Enterprise resilience is more about adapting to the risks than recovering back to normal. This prioritizes the task of anticipating, preparing for and adapting to both emerging and material risks. To do this effectively, the board and management need to look beyond the obvious and near term as well as dedicate time to discuss changes and trends observed in the market.

Technologies – such as artificial intelligence (AI) and advanced analytics – to scan the horizon for black swans and gray rhinos can help. Applying quantitative analyses to specific scenarios can enable the board and management to better understand the organization's full exposure to these risks. This can also allow them to better understand whether the current business strategy and model remain viable amid emerging risks and whether adaptation is needed.

Strengthen oversight of talent and culture

Talent shortages, ongoing workforce transformation and the competing needs of a multigenerational workforce are longstanding issues that companies have had to deal with. The need for flexible working together with a misaligned culture is increasingly becoming central to the talent risks that organizations face. With fast-changing technologies, the workforce also needs to be equipped with future-ready skills.

The board needs to support the management to identify and meet the organization's business-critical talent needs and create an organization that can adapt to changing expectations around culture, skills, and diversity, equity and inclusion. With improved knowledge, flexibility and oversight, it can help the management develop the human-centered culture needed to achieve this. It can also challenge the management to build a pipeline of leaders who live and breathe that culture.

Act on climate change

The connection between environmental sustainability and business resilience is indisputable and companies are facing heightened expectations from multiple stakeholders. These include investors, who want to know more about the organization's environmental, social and governance (ESG) performance, against the short-term earnings and longer-term investments in sustainability. At the same time, authorities want transparency in sustainability disclosures and evolving standards like the recently released IFRS S1 and IFRS S2 by the International Sustainability Standards Board are giving less leeway for ambiguity in sustainability reporting.

Yet, this is also a valuable opportunity for companies to demonstrate their progress in sustainability performance beyond compliance. Highly resilient boards are both more aware of material sustainability issues and more comfortable with discussing them. That is usually the result of assigning and creating accountability over ESG risks – whether it is a committee that takes the lead or the whole board. Boards can also gain investor trust by overseeing robust processes for collecting, managing and disclosing trusted data to comply with regulations. Where talk does not translate into actions, the board should challenge the management on its plans and commitment. To discharge its roles well, improving board knowledge and skills in sustainability is vital.

Understand risks from emerging technologies

With breakthroughs in generative AI technology, the advent of the metaverse and growing cyber threats, the goalposts in dealing with digital technologies are shifting fast.

As organizations invest more in digital technologies, the board and management will benefit from having the expertise to identify potential technology opportunities and risks. Of course, their job is not to be experts but to make sure the organization is balancing the speed of technology adoption with risk appetite and exposure.

To this end, the board should work more closely with the management to keep abreast of key investments in technology, digital transformation and cybersecurity. Cyber threats and digital risks are an enterprise-wide concern and this tone needs to come from the top. This means that driving the management to prioritize education and upskilling of employees on digital and recognizing that managing digital and technology risks is not just the remit of IT is key.

In an increasingly complex world, organizations need to be better prepared for long-term risks. Like in a zoo where one will need to stand back a little further to more clearly see the animals in the context of their environment, such clarity from the top and front is non-negotiable for boards.

This article was sourced from EY Center for Board Matters: How boards can drive resilience in today's zoo of risks

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