Good Governance In The Boardroom Through Responsible Corporate Tax Decisions

30 June 2025

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Good governance is a top-down approach permeating the entire organisation. This is no different when it comes to corporate tax decisions. As such, an organisation's highest governing body — that is, the board of directors — must set out good governance in tax matters by default.

At its core, a company's tax status, payments and strategy are very much corporate governance issues. The key tenets of corporate governance are accountability to stakeholders and transparency. As such, administrative steps like disclosing and elaborating on tax status, payments and strategy are very much in line with good corporate governance.

The definition of good corporate governance has rapidly developed over the past few years and is by no means static. The Organisation for Economic Co-operation and Development (OECD) has introduced global measures to tackle tax avoidance and tax planning. Deloitte highlighted in a report entitled "Governance in focus, keeping pace with tax change: A briefing for non-executives" that the OECD's Base Erosion and Profit Shifting Plan (BEPS) addresses international tax avoidance and increases tax accountability. OECD's action plan for BEPS aims to address tax challenges of the digital economy; establish international coherence on corporate income tax; restore the full effects and benefits of international standards; and ensure transparency and rapid implementation.

International Perspectives On Corporate Tax Governance

In a survey among European tax professionals, Deloitte found that three main pillars underpinned proper corporate tax activities. These include refreshing group-level approaches to tax management (inclusive of tax policy and strategy); developing communications strategies for taxes with the development of additional disclosures within financial statements; and, where needed, making specific changes as part of adaptation measures that account for changing environmental and commercial priorities — which could include different types of planning.

In the UK, the tax authority — that is, HM Revenue and Customs (HMRC) — has implemented measures to ensure that large businesses treat tax as a corporate governance issue. Measures such as reporting, publishing and annually updating UK strategy are designed to disclose information on an organisation's approach to risk management and governance of its UK tax obligations, tax planning attitude, as well as the amount of risk the organisation is willing to incur for its UK tax obligations. Such measures are running in tandem with corporate criminal liability for tax governance failings, plus personal liability for senior accounting officers whose businesses suffer tax reporting failures.

Tax concerns also play a big part in environmental, social and governance (ESG) matters. The Malaysian Institute of Accountants (MIA) highlighted that under FTSE Russell's ESG rating systems, one of the themes addressed under the governance section of FTSE Russell's analysis rubric is tax transparency.

As such, proper and transparent tax governance is a key success factor for ESG criteria for several stakeholders and processes.

Boardroom Behaviour

Ftouhi Khaoula and Dabboussi Moez's study "The moderating effect of the board of directors on firm value and tax planning: Evidence from European listed firms" sampled 105 European-listed companies. They concluded that tax planning does not play a significant role in determining firm value. It was determined that a higher effective tax rate is associated with lower agency costs, less tunnelling and fewer related-party transactions occurring between majority shareholders. As such, tax enforcement can function as an external corporate governance mechanism, while also increasing firm value.

Interestingly, the study also found that there is a significant impact from the board of directors on shareholder valuations of an organisation that engages in tax planning, suggesting that board independence, diversity and dual functions have a significant and negative effect on the relationship between tax planning and firm value.

In this regard, boards should be considering if the organisation has a board-endorsed policy for tax management. On top of that, they should be looking at defining their appetite for tax risk. Additionally, boards should also look at whether accountabilities for the management of different taxes are clear within the organisation.

As for the management of tax risk, boards need to make active decisions about the amount of tax risk considered in the design, implementation and maintenance of commercial decisions — that is, mergers and acquisitions, market penetration and product launches. Boards should also review and ensure that the right capabilities and structures are in place to support senior management in their evaluations of presented tax risks amid a context of highly technical tax issues. Not to mention, the boardroom agendas also need to include adequate financial provisions for tax risks.

Company boards also need to look at the processes and systems that are in place to identify, evaluate, manage and report tax risks to senior management. They also need to evaluate the extent to which internal audits ensure that existing controls used to manage tax risks are appropriately designed and implemented. Furthermore, they also need to look at the steps that have been taken to ensure that the relevant tax expertise is applied, particularly given the implications of key transactions.

The Need For Transparency

Another dimension that boards need to address is transparency. These are namely around whether the relationship between a company's income statement, tax charge, tax paid and business results — on a global and country-by-country basis — is explainable. At the same time, company boards must look at the presence of significant disagreements with tax authorities and the timelines required to resolve such disputes.

The OECD has outlined four major areas to focus on for effective tax governance, namely:

- **Policy:**

  Developing a clear, board-endorsed tax policy that defines risk appetite and sets accountabilities for different taxes within the company.

- **Risk Management:**

  The need for boards to understand how tax risks are considered in commercial decisions such as mergers, acquisitions and market expansions. Provisions should be made to ensure adequate financial preparation for tax risks.

- **Processes And Systems:**

  Effective tax governance requires robust systems to identify, manage and report tax risks. Boards should ensure that internal audits are thorough and that tax experts are consulted for key transactions.

- **Transparency:**

  It is essential that tax charges, payments and business results are explainable on a global and country-by-country basis. Boards must also ensure that any disputes with tax authorities are addressed promptly.

Given the importance of a company's board of directors and the increasing amount of attention paid to tax governance, they must be able to manage tax issues seamlessly. With the growing scrutiny of corporate tax practices and the evolving regulatory landscape, the board of directors must actively manage tax governance. A well-structured approach to tax governance not only ensures compliance but also strengthens the organisation's transparency and reputation. Good governance in tax matters is a key enabler of long-term corporate success, fostering trust among stakeholders and securing a company's standing in the competitive market.

* *This article was authored by the firm's Tax, SST & Customs partner, S. Saravana Kumar and first appeared in The Edge Malaysia Weekly on 23 June 2025 to 29 June 2025.*

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