

# TAX FACTOR AND CORPORATE GOVERNANCE. CHANGES IN AUDITING IN THE INTERNATIONAL BUSINESS OF CORPORATE GROUPS

Pietro Pavone \*

\* University of Sannio, Italy



**How to cite:** Pavone, P. (2019). Tax factor and corporate governance. Changes in auditing in the international business of corporate groups. *Corporate Governance: Search for the Advanced Practices*, 52-56. <https://doi.org/10.22495/cpr19a15>

Copyright © 2019 The Authors  
This work is licensed under a Creative Commons Attribution 4.0 International License (CC BY 4.0). <https://creativecommons.org/licenses/by/4.0/>

**Received:** 27.12.2018  
**Accepted:** 17.01.2019  
**JEL Classification:** M10, M42, K34  
**DOI:** 10.22495/cpr19a15  
**Keywords:** Corporate Groups, Corporate Governance, Tax Law, Tax Auditing

---

## Abstract

Growing international competition has led to an increasing number of enterprises to seek new opportunities on foreign markets.

In our global world, even the corporate structure has had to adapt to the new market conditions; from the point of view of the organisation of the processes that make up the value chain they have had to become more flexible and take on a more global footprint.

This research paper is focused on corporate groups, one of the most widespread corporate organisational solutions in managing global business deals. We analyse the changes in the organisation of companies that have completed their internationalisation process or that are about to do so. We focus on how the tasks and responsibilities of the main internal control staff have changed and the relationship with the various management bodies. In particular, we will try to discover how corporate groups with an international vocation reconcile the need to manage tax variables with the need to ensure that the group's central management team does not merely pursue interests that are common to all the group's subsidiaries but, rather, manages a real enterprise comprising various legal entities.

The paper culminates by proposing certain operational tools designed on the logic of enterprise risk management that can guarantee advanced and strategic management of the tax risks associated with international business.

In an international business environment, the division of a basically single enterprise into several legal units is not without pathological dangers, especially where tax matters are concerned.

The proposal for this research stems from a fact: the studies conducted by the Organisation for Economic Cooperation and Development (OECD) have highlighted that there is a widening gap between where business activities and investments are conducted and where profits are registered for tax purposes. Some authors (Vinciguerra & Valente, 2016) have introduced the concept of “fiscal nomadism”.

It is important to note that corporate groups tend to structure their tax departments over time not only to fulfil all the requirements of the tax regulations in the various countries the individual legal entities operate in but also to identify the options open to them to reduce the group’s overall tax burden by sometimes implementing aggressive tax planning. It is currently impossible to identify important critical issues whether from a legal perspective or from a financial-business perspective.

Analyses of the regulatory instruments to combat the tax evasion and tax avoidance practices of international corporations continually highlight that national tax laws are basically inadequate when it comes to policing “global taxpayers”, given the contrast between the territoriality of laws and the universality of the subjects that are required to pay taxes.

Auditing is another critical issue: the traditional auditing function has limits since it is unable to provide a full set of information because it is rarely able to ascertain and reveal any aggressive tax planning operations and, when it can, there is usually a wide time gap between when the tax plan is implemented and when an audit discovers it. Furthermore, it is not easy for an audit to ascertain whether an aggressive tax plan is an isolated case or is part of a wider and structured phenomenon.

It is believed that, at present, there is room for manoeuvre by intervening on the audit function itself, improving its effectiveness, especially in the management of the tax risks of international companies and enhancing the role of corporate groups’ internal auditors as internal bodies of the parent company whose task it is to check the activities of the subsidiaries (Lemme, 1997).

The work at hand, starting from the analysis of the main tax issues deriving from a company’s activities on the international stage (an “explorative” analysis) is addressed, first and foremost, to uncovering the critical tax issues connected with the internationalisation process: i.e. critical issues connected with the location of the company (corporate

relocation abroad), critical issues related to the dynamics of cash flows (transfer pricing), critical issues related to the tax regimes (relations with countries with "privileged" tax rates).

The decision to contextualise the empirical field by concentrating the research on corporate groups stems from the belief that the international organisational structure of corporate groups is well suited to grasping the most important tax ideas on operating in economies with multiple different tax laws (Garbarino, 2005; Guerra Cordeiro, 2012).

The shift from the classical shareholder view to a wider stakeholder view has emphasised the importance of corporate governance, which takes centre stage in the relations among the company's stakeholders (Salvioni, 2007).

In detail, the goal of this research is to examine the crucial role of tax governance in the management of "international" companies.

The ultimate goal of the research is to propose some valid operational tools within the company's control system in order to:

- give substance to what the OECD has said about the transition from the concept of an "enhanced relationship" to "cooperative compliance" in the relationship between Tax and Taxpayer, outlining principles and criteria of good tax governance (Tarallo, 2000);
- consider the social interests of all the players involved in corporate dynamics (stakeholder approach) and to interpret the tax governance issues in the light of the principles of Corporate Social Responsibility;
- reach a balance between the need to safeguard tax interests and, at the same time, the need for taxation not to become a hurdle to international trade and investments.

From the methodological point of view, the analyses were carried out by removing the filter of national law that is by abandoning the conceptual schemes of the Italian legal system and assuming a necessarily supranational perspective.

In the analysis of the sources, emphasis was placed on the so-called "Law in action" rather than the "law in book", thereby leveraging on the best practices of international corporate governance and on the principles recommended by the OECD: if in an internal perspective it is the relationship between the state and its citizens/taxpayers that is examined, in an external and wider perspective at the centre of the analysis is the process of interrelations between sovereign states. The bibliographic research on internal auditing has been adapted to the specific subject of the analysis (a multinational group of companies).

The assumption on which this paper is based – the core of the entire work – is that the main issues underlying the corporate internationalisation process ("crossing" the value chain, cross-border trade relations, relocation of subsidiaries abroad, etc.) – thereby introducing new areas of uncertainty to be managed and controlled – involve changes in the physiognomy of the traditional corporate functions

that are responsible for internal control, changing their structure, tasks and the way they interact. We believe it is useful to focus on the evolutionary trends of a company’s internationalisation process and to try to understand the tax culture that the internationalisation process fosters: the idea is that the development of a “corporate tax compliance culture” (Pavone, 2016) produces positive effects on Corporate Social Responsibility (Lizza, 2005).

Within the framework of the management of the corporate internationalisation process, the internal auditing function is thought to play a central role which, especially in corporate groups, constitutes, for the parent company, a valid instrument for information and control on the activities of subsidiaries (Lemme, 1997). When we consider its doctrinal and practical evolution, we can say that the internal auditing function is the most suitable function, due to its characteristics and operating methods, to develop constant dialogue with the tax departments of the various subsidiaries making up the group. Indeed, thanks to its functional place within the group, the international auditing department is in the ideal position to not only carry out the required checks but also to issue the necessary directives or operating instructions, thereby facilitating the links with the other corporate departments.

The research path, as outlined above, can be fully addressed through an in-depth analysis of a set series business facts, which can provide material and information for this research.

As explained, governance in corporate groups with an international vocation can be understood as an intermediary activity between the stakeholders and the management of the company in order to “transfer the best ways to satisfy external expectations into the way a company behaves and its activities” (Gandini, 2004). If this is true, then auditing may be a crucial element in supporting this purpose and in supporting the sharing of full corporate responsibility.

The first fundamental findings in terms of expected results will be confirmation of the relevance of the “internationalisation variable” in redefining the various kinds of organisation in companies. The internationalisation processes raise many questions about corporate organisational structures: measurement of the variations that will be identified in the departments responsible for internal control will be assessed in terms of new procedures implemented, other forms of control exercised as well as the integration of intercompany information flows.

When we assessed which assumptions had to be examined, we asked ourselves whether the risk management and mitigation model brought in by Legislative Decree 231/2001 (Irrera, 2009) could be of help, if it were adapted effectively to the particular purpose, to implement a risk management department to manage the tax variable in an international economic perspective.

This research has so far basically confirmed the hypothesis. It is believed that the emergence of a qualified sample of cases of companies that have successfully used tax-risk management models that are inspired by the profile examined here can contribute to further corroborate the hypothesis in question. Indeed, there is a significant possibility of “increasing corporate governance practices by working on the connections between risks, results and resources” (Ferrara, 2009).

The definition of an internal control system has recently changed to an instrument of Integrated Enterprise Risk Management to safeguard company resources and to create value for all the stakeholders (Salomone, 2013). Based on this perspective, the search for optimal corporate governance models – honed to allow optimisation of the potential for international growth, according to the logic of fairness, reliability and transparency – will lead to the establishment of a modern “risk based audit” that is far from that of functional “auditable units”, the main subject matter of an audit, and more skewed towards assessing the risks of the units themselves (Gandini, 2004).

Lastly, the work thus conceived will make it possible to clarify the boundary, which is even more blurred in an international dimension, between virtuous tax governance policies and speculative strategies of aggressive tax planning.

It is believed that the small number of researchers in this particular sector of interest constitutes an academic gap that needs to be filled to improve the tax policies implemented by multinational companies.

## References

1. Ferrara, D. (2009). *Governance and risk management models*. Milan: Franco Angeli.
2. Gandini, G. (2004). *Internal Auditing and risk management in corporate governance*. Milan: Franco Angeli.
3. Garbarino, C. (2005). *International taxation manual*. Milan: Ipsoa.
4. Guerra Cordeiro, R. (2012). *International tax law. Institutions*. Milan: Cedam.
5. Irrera, M. (2009). *Profile of corporate governance of joint-stock companies: Responsibility, controls and balance*. Milan: Giuffrè.
6. Lemme, G. (1997). *Group governance*. Padua: Cedam.
7. Lizza, P. (2005). *Corporate culture in enterprise governance*. Milan: Giuffrè.
8. Pavone, P. (2016). *Corporate strategy and tax perspective*. Quadrimestre di Business and Tax.
9. Petrocelli, M. (2005). *Organisation learning and how to measure it in the corporate strategy. Organization learning and learning organization profiles, currently being examined*. Rome, Italy: Armando Editor.
10. Salomone, I. S. (2013). *Systemic governance of risks in corporate management: A balanced scorecard for risk management*. Milan: Egea.
11. Salvioni, D. M. (2007). *Corporate Governance, controls and transparency*. Milan: Franco Angeli.
12. Tarallo, P. (2000). *Corporate Governance. Management principles with a view to values*. Milan: Franco Angeli.
13. Vinciguerra, L., & Valente, P. (2016). *Foreign tax evasion of persons: Center of vital interests and fiscal nomadism*. Milan: Ipsoa.