



Tax in the boardroom

Tax risk management – key considerations



The tax landscape has changed and it has never been more important for your business to demonstrate control over its tax risks.

Getting its tax wrong can bruise a company's reputation and its shareholder value. Yet the company's tax position is becoming increasingly transparent and legislation is playing a part in this - take, for example, the Sarbanes-Oxley legislation where a company that fails to maintain adequate internal controls over its financial reporting may find itself having to disclose deficiencies in tax accounts and disclosures.

Aside from this drive for robust internal controls, there is also increased interest from investors and the general public in the way in which companies manage their tax affairs. Add to this, evidence of increasing co-operation between revenue authorities (internationally and domestically) which is leading to a more joined up approach to enquiries and risk assessment, and it's not surprising to see why many companies are beginning to take tax risk seriously. Some have formulated and documented a tax risk policy; others have gone so far as to appoint tax risk managers.

The right tax risk policy will help ensure that tax planning is both effective and appropriate and that compliance obligations are met – its very existence can reassure investors and stakeholders that the company's tax affairs are under control and that tax risk is being taken seriously. The right tax risk policy will also weigh up the value that can be achieved by taking risks, the costs savings gained by reducing risks and the resources required to do so. It will address the numerous sources of tax risk in the business, many of which stem from outside of the finance function, and can reduce the occurrence of unnecessary compliance costs and unplanned and increased tax. Getting tax risk wrong on the other hand, can knock investor confidence, damage relationships with revenue authorities and lead to negative media coverage.

This booklet is designed to give you an overview of our current thinking on tax risk and offer some helpful suggestions on how to address such risk.

A handwritten signature in white ink on a blue background. The signature is cursive and reads "Richard Collier-Keywood". A long, thin horizontal line extends from the end of the signature to the right.

Richard Collier-Keywood
Head of Tax, UK



What is tax risk?

Broadly, tax risk occurs in the following key areas:

Transactional risk

Transactional risks are those associated with the application of tax laws, regulations and decisions relating to specific transactions. Generally, the more complex or unusual the transaction is, the greater the tax risks involved. One-of-a-kind transactions, such as the acquisition or disposal of a business or parts of a business, or significant restructuring projects and reorganisations, generally bear greater tax risks than routine everyday business operations, such as selling products and services. In addition, well-designed procedures and systems are likely to be in place to support the processing of routine transactions; these procedures and systems usually would not apply to unique or non-routine transactions.

Further significant transactional risk may occur if a company fails to implement properly what has been planned and agreed upon. When the best planning falls short of its mark because implementation has been inadequate or there have been gaps in monitoring a particular legal requirement, a by-product may be a compromised or unintended tax result. Increasingly, revenue authorities are asking to see the full documentation relating to a particular transaction to test whether the implementation has achieved the result claimed by the company. (Note: The potential documentation requirements legislated under The Sarbanes-Oxley Act and the new Tax Shelter Disclosure and List Maintenance Rules may also need to be considered, depending on the particular transaction.)

Think about how much tax risk your company is prepared to take in any given transaction. In complex transactions, how much risk are you taking with respect to the correct implementation of the transactions?

Operational risk

Operational risks are those which arise from the routine, everyday business operations of the company. Different types of operations will have different levels of associated tax risk. We have observed that the tax authorities in a number of jurisdictions recognise that normal third-party product sales are distinctly different from intra-group cross-border product sales, and so are placing increased scrutiny on a company's transfer pricing. Similarly, the authorities are increasingly focussing on 'taxable presence'. As globalisation increases, there is an ever-greater chance that operational people will inadvertently create a taxable presence in a country in which they are operating. These are only two examples of tax risks that can arise from normal, ongoing business.

Typically, the closer the tax function is to the business operations, the better these risks are managed and communication between the various parties is key. Where does your company fall on the operational risk scale? Where would you like it to be? Also, who are the key creators of tax risk in your business? This includes those outside of the finance function who undertake activities which have a tax impact (e.g. Procurement and HR).

Compliance risk

Compliance risks are those that are implicit in the processes and procedures adopted by a company when preparing and submitting its tax returns. It also applies to the responses you make to any enquiries or issues raised by regulatory authorities.

Where is your company on the compliance risk scale? Where would you like it to be? What would have to change to get there? In addressing these questions, also consider the various departments that may be involved in tax compliance areas such as payroll tax, sales and use tax, as well as customs and duties. These may sit outside the tax department and should be considered.

Financial accounting risk

Amounts included in the income tax accounts at the time the financial statements are issued are estimates. In fact, deferred income tax accounting generally calls for the estimation of future taxes to be paid under tax regimes on transactions that are recorded in the accounts in the current year. Avoiding negative adjustments to the tax accounts has always been high on the agenda of most heads of tax, who have told us that their CFOs want 'no surprises' and this has probably made them more risk adverse. Section 404 of the Sarbanes-Oxley Act is proving challenging for many companies, with its requirement that companies document and test internal controls over financial reporting.

The following questions might provide a basis for identifying and framing the tax risks that are embedded within the financial statements:

- How much uncertainty is there in the interpretation or application of the tax law(s) used to compute the tax?
- What is the quality of the data received from or used in the transactional, operational and compliance areas?
- Are there complex or unusual financial reporting or disclosure issues?

Tax risk occurs in all companies however, some companies are subject to additional risk, in particular those:

- which allow their business units a high degree of autonomy where tax is concerned
- undergoing an acquisition or transaction
- with open enquiries with regulatory authorities
- converting to IFRS
- in the financial services industry where front office operations carry additional risk
- with share incentive plans



How can tax risk be managed?

Broadly, tax risk management involves addressing three key questions:

How do I determine a suitable tax risk policy and what level of risk is acceptable?

A good place to start is with the company's broader business strategy. For example, look at the overall risk, social responsibility, brand and reputation strategies – what do they tell you about your company's appetite for risk? What are your company's objectives and those of its current and future stakeholders including investors? What emphasis is placed on cost reduction and/or reputation? These are just a few important considerations - a tax risk policy which is not aligned with these wider business needs may cause problems down the line.

Another thing to remember is that tax risk management is not necessarily about minimising risk. Businesses make profits by taking risks and a no-risk strategy is probably neither cost effective nor right for any business. Your tax risk management policy therefore needs to weigh up the value that can be achieved by taking risks, the costs that can be saved by reducing risks, and the resources needed to manage both the upside opportunities and the downside risks.

What are the tax risks in my business and how do they fit with my chosen risk policy?

This involves identifying the transactional, operational, compliance and financial accounting tax risks (described above) inherent in your business. Which risks are avoidable or not in keeping with the company's chosen tax risk policy?

What controls, communication and monitoring procedures do I need to put in place?

There are numerous considerations. Here are just a few of the questions you might ask:

- Are risk control procedures in place?
- Do those outside the tax function know when they need to consult the tax function and vice versa?
- Are control activities communicated and embedded throughout the organisation?
- Is it clear who has responsibility for individual control activities?
- Are you properly supporting those who have a risk mitigation role?
- Is there a process in place to monitor tax risk management control activities?



Where can I find out more?

If you would like further information on this topic you may wish to order a free copy of the PwC Tax Risk Management Guide via our website (pwc.com). Alternatively, why not call your usual PwC contact or one of our Tax Risk Services specialists listed opposite. They can help you:

- formulate and document a suitable tax risk policy.
- evaluate your current tax risk position and identify specific existing and potential tax risks.
- identify and implement relevant controls and processes.

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