



## Tax Compliance

### Revisiting Tax Risk Management

*This article and accompanying resource was provided by Ana Sainz of [The Claret Partners Limited](#), a consulting firm dedicated to providing the best in regulatory compliance, tax, risk and governance services as consultants and project managers creating workable and practical solutions.*

During the early part of this decade, tax risk received a fair bit of press. Tax manipulation was thought to be a contributor in the demise of large US-based corporations, accounting firms had their knuckles rapped for soliciting unsavoury tax shelters and many countries instituted internal control-related regulations that identified tax processes as having material weaknesses. We have provided a downloadable copy of a tax provision's top ten tax controls at the end of this article to assist you in reducing your control weaknesses.

The general reaction was to hunker down, clean out the tax contingency reserve, document the rationale for all the reserves and ensure that each tax working paper is reviewed and initialled. Some tax departments used this as a means to gain additional bodies – sorely needed for tax but instead employed to maintain the plethora of templates and sign-offs required by internal and external auditors. So the question is: Are we any further ahead in addressing tax risk? As always with tax, the answer is: It depends.

Many companies took the internal control requirements regulated in Canada and the US as a means to assess how they performed certain routine functions – mainly the tax provision. This is the regulatory focus as it is the current and deferred taxes in the financial statements over which internal controls are being assessed. Additional provisioning steps that were completed but added little value as mitigating controls were eliminated or performed less frequently, freeing up valuable time. Some companies went as far as to integrate the accounting systems into global tax provisioning software to reduce potential mechanical errors and to increase the timeliness in which they receive adjusted accounting figures. And it has helped; the significant weaknesses noted in prior years are being rectified and strides have been made in reducing the operational tax risk that arises from the mathematical and mechanical process of the tax provision.

As tax practitioners, we know this is only half the battle – the heavy issues lie with interpretation of tax laws, correct implementation of tax plans and the tax department's alignment and integration with the overall corporate strategy.

Tax risk management as a practice has also been around for a number of years; each large accounting firm has its own methodology: similar in nature yet varying in presentation. Most senior tax personnel would agree that a comprehensive, robust tax risk management plan is a good idea; unfortunately, the idea typically dies when you see the proposed price tag for the plan. Yes – you are paying for access to methodology, tax expertise and additional staff to complete the plan, but in reality who knows your processes and issues better than your in-house staff? What you actually need is the framework, templates, tools and time to pull together a manageable pile of data and turn it into an understandable plan.

### Basic Tax Controls

If you think about it, the internal control work you already perform is a good beginning. The templates used to document your tax risks over the tax provision (and the mitigation controls) could be extended to address tax risks that do not impact the financial statements directly. A prime example would be controls over the preparation and filing of the tax returns. [Note 1](#) Late filing interest and penalties and errors made in the compilation of the return are tangible errors that can be reduced. In addition, analyzing the differences between the provision's and filing numbers can provide insight as they can result from a differing interpretation of tax laws, weak assumption or understanding of business products and operations, and poor forecasting.

Extend the template to insert action steps for each risk item. The risk identified will be at varying stages:

1. Further research and assessment.
2. Assessment completed and quantification required.
3. Quantification complete and determination of appetite for risk – eliminate, reduce or take advantage of its potential.
4. Determine alternatives that align themselves with the appetite for the tax risk and overall corporate strategy.
5. Propose or report to senior management and/or Board.

### Implementation Review

A tax plan implementation review can be a significant source of information – good and bad. Accompanying a major tax plan is generally an Advance Tax Ruling (“ATR”), a steps memo or tax opinion letter (or all three), which outlines under what circumstances the desired outcome is permitted or will succeed. Most companies are diligent in ensuring that this forethought occurs, but are much less diligent in ensuring that they are implemented in accordance with the plans originally outlined. Even fewer still return to the plan two or more years later to ensure that it remains in place correctly and is operating as envisioned. Changes in tax laws, political stages and corporate strategies can all impact how successful a tax plan really is after its implementation. As examples:

- Corporations have a tax-advantaged financing plan implemented that includes the assumption the Canadian dollar remained within a certain range against the US dollar; when the currencies come close to parity, the plan not only falls apart but becomes detrimental to the corporation.
- Other corporations have received rulings for specific sales or purchase transactions only to fail on subsequent taxing authority audits because the implementation did not adhere to the ruling received.

### **Tax Governance**

Senior management responsible for tax should have a specific section for tax-related items in their mandate. This should be more than the basic "ensuring compliance with tax laws and reporting requirements"! It should provide parameters on how active the tax department should be in looking to opportunities to reduce the effective tax rate and authority levels over implanting tax plans (what type, local or global and dollar value assigned). [Note 2](#) These parameters should adhere to the overall risk appetite of the corporation and should be mandated by the Board to ensure that they also are aligned with corporate strategy.

At the Board level, if there is a risk committee, it is generally focused on market, credit and liquidity risks and does not include tax. Tax is usually under the umbrella of the audit committee, yet few audit committee members have a good understanding of tax issues and related risks. Ensuring the audit committee has adequate information composed in a language they can digest and make informed decisions in respect of tax risk is a challenge all onto itself.

### **Communication**

Tax must be part of the discussion on strategic matters. This will ensure that the tax department is kept informed and able to manage tax risk, which is either a problem to be corrected and/or an opportunity to be taken. Tax can contribute to the discussion – improving the product's profitability (or reducing its overall cost). More frequent, active communication can also help ease friction between tax and other departments (notably accounting) as issues get fleshed out on a regular basis rather than waiting until a crisis occurs to "sort it out."

### **Plan**

In the end, whatever format your tax risk management plan appears in, it should contain the following items:

1. Board mandate describing the responsibilities of directors in respect of tax risk and its management.
2. Senior management mandates outlining the specific risk targets the corporation is comfortable accepting and has delegated to management.
3. Tax department plan outlining risks (quantified when possible) and action steps related to these items. These could be to assess the risk further (more research, obtain ATR, opinion, etc.), quantify, eliminate or reduce, or take advantage of it within certain parameters.
4. Tax plan implementation reviews completed on a rotating basis.
5. Internal controls over the financial reporting aspect of tax balances.
6. Documented minutes of regular (quarterly) meetings held with accounting, treasury, marketing, etc., to ensure that tax is kept involved in the corporate strategy. These will vary depending on nature of company.
7. Procedures manuals.

[Download the list of top ten tax controls](#) every company should have in place.

### **Notes:**

1. Generally, it is the controls over the provision to return adjustment that are tested and not controls over filing the return itself.
2. Authority over the ability to sign a return that carries back tax losses on a local basis is different than the authority to establish offshore companies and transfer property to lower the global effective tax rate. The former may be delegated to management; the latter may require Board approval.