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Corporate tax delivery

Corporation tax

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Donald Drysdale considers corporate tax compliance risk management issues, looking particularly at potential weaknesses in delivery and an approach to remedying these.

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Key Points

- Through OECD, the UK leads the world in tax risk assessment strategy.
- HMRC's Business Risk Review looks for weaknesses in delivery.
- On 17 September HMRC announced new guidance for its Large Business Service staff.
- Systems integration is weak in many in-house corporate tax departments.
- A tax process review can be a vital step towards improving delivery.

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The new focus on tax risk is an international phenomenon. Forty-five member countries of the Organisation for Economic Co-operation and Development meeting in Cape Town in January 2008 identified risk management as an essential tool to ensure optimal use of revenue bodies' resources. They advocated the development of enhanced relationships so taxpayers behaving transparently could expect greater certainty and earlier resolution of tax issues, with fewer audits and lower compliance costs.

Tax administrations are studying closely how businesses manage their tax compliance risks. They want to forge enhanced relationships with taxpayers and intermediaries to obtain tax risk information sooner. Governments increasingly co-operate and exchange information about industry sectors and multinational companies. Those that shun transparency have fewer places to hide.

In the UK, the new approach by HMRC to assess tax compliance risk is spearheaded by their Large Business Service but will soon pervade all of HMRC's operations.

Links with large business

HMRC led the OECD study, and the LBS initiative pre-dates Cape Town. It arose from Sir David Varney's review of HMRC's links with large business, published in December 2006. This called on HMRC to adopt a new approach to enquiries, concentrating on risk areas and reaching swifter conclusions, while delivering benefits to compliant businesses. It sought a risk-based approach to compliance reviews, using system and control testing to ensure robustness of business processes.

The 2007 Budget unveiled further details, and last December HMRC published guidance on 'tax compliance risk management', aimed at LBS staff and the taxpayers they handle. HMRC announced on 17 September that LBS customer relationship managers are now sharing aspects of their revised risk management framework with taxpayers before it is finalised and published more widely.

The business risk review

The starting point for the LBS is its business risk review of each taxpayer, assessing tax compliance risks relating to each tax and duty. This categorises risks as either inherent complicating factors, e.g. complexity of structures, boundary issues, or degree and pace of change, or aspects of the taxpayer's compliance approach, e.g. tax strategy, governance or delivery.

All businesses that were in the LBS last year should have had a risk review completed already, evaluating them as 'low risk' or 'not low risk'. This determines the nature and frequency of HMRC's interactions with them. The LBS aims to categorise 40% of businesses as low risk. Those who passed with flying colours will want to remain within this quota, while many who failed to achieve this will want to improve their future ranking.

Typically a low risk relationship is open and transparent, with the taxpayer drawing HMRC's attention (mainly in real time) to difficult issues or those where a high level of judgment is required to determine the tax treatment. In such cases, HMRC will not generally initiate further risk assessment activity for two or three years, and will minimise other verification work. On eventually revisiting the risk review, only the most recent year will generally be examined.

By contrast, taxpayers classed 'not low risk' can expect annual or continuing risk assessment processes to monitor overall risk status. They may enjoy low risk status for certain taxes and duties; identified risks are scored by reference to value, probability and impact, and the most significant will attract appropriate attention from HMRC.

Some businesses rated 'not low risk' because of inherent factors such as complexity and change may still try to minimise compliance risks within their control to smooth their relationship with HMRC.

The remainder of this article concentrates solely on delivery: the taxpayer's ability to deliver the right tax through systems, processes and skills.

Assessing delivery risks

Delivery represents the nuts and bolts of tax compliance. HMRC look for a history of accurate and timely returns, declarations, claims and payments across all taxes and duties. They hope to find records, systems and procedures that are clear, robust, readily auditable and tax-sensitive, delivering the right taxes and duties at the right time. Tax staff involved should have suitable skills and be adequately supervised to assure integrity where judgment is needed.

HMRC expect to find systems and software that are appropriate and fit for purpose, including 'accredited' or 'approved' software (though their accreditation applies only to certain specialist areas), and proper and sufficient controls and clear audit trails to manage interfaces between systems.

Interfacing systems is a big issue. In most large organisations, ERP (enterprise resource planning) systems provide data on operating divisions. By contrast, tax departments face the time-consuming task of gathering tax information from individual companies (which are separate entities) while also consolidating these into group tax charges.

Tax department requirements are not always well served by accounting and ERP systems or consolidation and business reporting tools. Tax is often overlooked on implementing new systems, sometimes because the tax function is not understood by external systems integrators.

Furthermore, such systems typically do not possess the functionality needed to produce tax numbers; they may provide the necessary inputs from the business, and store the computed tax answers, but fail to support the complex calculations required or create an appropriate audit trail.

Pressures of work can create opportunities for error. In-house tax departments face heavy workloads driven by demanding reporting commitments and continuing tax planning requirements. In acquisitive groups, mergers and acquisitions and other special projects impose additional demands.

In many businesses, tax compliance relies heavily on spreadsheets. These offer flexibility for gathering data from individual companies and compiling group tax figures, but there can be difficulties in controlling spreadsheet quality and providing adequate audit trails. Furthermore, auditors can impose differing demands every year and can spring last minute requests for information and reconciliations. HMRC may have concerns about reliance on multiple spreadsheets, and about tax compliance errors arising from inadequate controls.

Spreadsheets can be deceptively simple to create and maintain, offering users wide-ranging functionality in manipulating data. Tax specialists welcome the power this gives them, but it can be dangerous. Spreadsheets used by one individual may be indecipherable and virtually useless to anyone else, especially after the originator has moved on. Linked spreadsheets may become unsynchronised. Spreadsheets used by a team may be created, used and maintained inconsistently by different users, leading to unexpected errors.

Lowering delivery risks

Tax workflow systems using a database approach can provide a safer tax reporting environment -- with loss of flexibility more than recompensed by improved quality control. Tax departments using such systems to bring together group tax figures and manage related compliance tasks, such as tracking the tax histories of heritable properties and other fixed assets, may have more success in establishing a low risk rating.

Database-driven systems can offer specific advantages over spreadsheet equivalents. For example, they can provide secure multi-user, multi-location access across networks, structured user level security, effective validation of data input and trouble-free carry forward of figures from one year to the next. Overall, they guarantee a more secure working environment, crucial in minimising perceived tax compliance risk.

Bespoke database systems are not the only alternative to spreadsheets. There are off-the-shelf systems that stand somewhere between the two and need to be configured to meet particular requirements. Some originate in the US and may therefore need to be adapted for UK generally accepted accounting principles and international financial reporting standards as well as UK tax.

Change is neither easy nor popular. Migrating the work of a large tax department from spreadsheets to a tailored workflow solution can be daunting -- and easily avoided on grounds that the upfront costs are prohibitive. However, the costs of not exploring such options may prove to be much higher.

Tax process review

The first stage towards improving tax workflow is likely to be a tax process review, similar to HMRC's business risk review, but carried out by independent specialists with in-depth knowledge and understanding of the in-house tax world. As tax professionals themselves, they will have the expertise to offer ideas and solutions that address the needs of those responsible for the tax processes.

The review will seek to identify and clarify the current tax compliance and reporting processes used, identify key risk areas that exist, and outline suggested improvements to processes and technologies to mitigate those risks. This can be crucial in putting the work of the department on a sounder footing, better able to cope with HMRC's risk assessment demands.

Implementing improvements

A big bang approach is rarely appropriate for a tax transformation project. Hard pressed tax staff will prefer incremental changes, concentrating on quick wins at the outset, leading to other benefits in stages until the ultimate goal is reached. Such an approach allows small improvements to be applied, tested and optimised successively on an iterative basis.

A project might start by improving the tracking of compliance progress, then gathering data to monitor tax positions and creating a tax knowledgebase, using a 'tax dashboard' approach. It might then improve the link between tax processes and ERP and consolidation reporting systems by bridging data between Oracle, SAP, Hyperion, etc. and tax accounting and tax compliance tools. Finally it might address more complex areas such as transfer pricing adjustments.

Other benefits should emerge. UK corporate tax uncertainties are persuading many boards to look closely at international structures and question whether they wish to remain UK resident. Assessing the impact of existing and proposed tax legislation in multiple jurisdictions requires accurate tax data flows from all parts of the group, and improved tax compliance processes should provide these.

Conclusion

In many large in-house tax departments, opportunities will exist to strengthen the tax compliance delivery mechanisms. By carrying out an appropriate review and introducing tailored incremental IT solutions, they may put themselves in a stronger position to satisfy HMRC's stringent new risk assessment process.