Is Your Company Effectively Managing Tax Risk?

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The concept of "tax risk" is an important and regular topic of discussion across organizations and in boardrooms, and for good reason. Businesses that operate across state lines or internationally can in certain cases trigger tax liabilities in jurisdictions where they do not have a physical presence. In addition, many countries are adopting policies requiring greater transparency in tax and financial reporting, providing tax administrations more information with which to raise investigations and issue assessments. As companies place additional focus on social responsibility and fiscal transparency, the benefits of having a tax risk policy in place can be substantial. Given the rapidly changing global tax environment, an effective tax risk policy is necessary for any business that needs to better manage tax risk.

Insight

Every business decision has a tax implication, and with each decision comes the potential for tax risk. An important part of managing tax risk rests with the ability to proactively analyze and plan for the tax effects of business transactions as well as correctly reporting the associated tax consequences. A sound tax risk policy should involve your CPA as business decisions are being planned and executed so that the associated tax implications may be effectively assessed in real time. Effective processes and controls that include regular, transparent communication with non-tax leaders and decision makers are essential.

What is tax risk?

Tax risk is a company's risk of incurring additional tax, interest or penalty costs due to incorrectly underreporting its tax obligations in its financial statements, or in tax or other regulatory filings. It also includes the risk a company will unnecessarily pay more taxes than it might otherwise legally owe due to missed planning opportunities and lack of a clear tax strategy. Tax risk generally is heightened when a company has, for example, multi-jurisdictional or cross-border transactions or complex supply chains, remote employees or agency arrangements, valuable intellectual property, or digital operations. Further, businesses that do not effectively manage tax risk also run the risk of reputational damage, for example, with investors or other stakeholders, or with tax or other governmental administrations. In addition, where errors are significant, companies may be required to restate their financial statements.

The benefits of a tax risk policy

A comprehensive and properly implemented tax risk policy helps ensure a company's tax behavior is in alignment with the company's overall risk profile. An effective tax risk policy also strengthens tax risk awareness across the wider organization through better communication, processes, and controls that include executive oversight of tax strategy. A well-developed tax risk policy will include:

- A clearly articulated tax strategy, approved by management and the board of directors, that is aligned with the risk appetite of the broader organization.
- Robust internal control policies, processes, review and oversight procedures around tax reporting and planning that can be shared with tax authorities and stakeholders or published as part of ESG reporting.
- Sufficient tax department resources, technology, and training along with clearly defined roles and responsibilities for tax department personnel.
- A documented policy setting out the company's approach to interaction with tax authorities and regulators.
- A regular cadence of communication with organization leaders and board members regarding tax strategy, as well as procedures to help ensure that tax risk is considered when engaging in business planning.

Is your company's tax risk policy effectively managing tax risk?
Every business should have a tax risk policy in place that not only articulates their tax strategy and vision but also reflects the way the company operates. In other words, to be effective, a tax risk policy must be consistent with the policies of the broader business organization.

In an ever-changing business and tax environment, an effective tax risk policy will include procedures that require the policy to be regularly assessed and modified as needed. Indications that your tax risk policy should be reviewed include:

- Increased tax examination activities or unexpected tax examination findings.
- Recent control deficiencies related to the tax function.
- Legislative changes.
- Tax department turnover or a department reorganization that could lead to loss of institutional tax knowledge.
- Upcoming M&A or other significant business transactions.
- Changes to business operating models or supply chains, organizational transformation, or similar business factors.
- Increased board or stakeholder inquiries related to tax, including around ESG concerns.

Please contact your tax advisor at Kernutt Stokes to discuss how we can help you manage you and your company's tax risk.