Tax governance –
The ultimate compliance solution

Meeting the challenge of an expanding regulatory environment
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Introduction

As the global business environment becomes more complex, organizations are under intense scrutiny from government, regulatory and other significant stakeholders. This is marked by a dramatic increase in legal and regulatory compliance obligations, coupled with expanding reporting obligations across all business areas, from compliance through to operations and tax. To operate effectively in this environment, organizations must rapidly develop and leverage a coordinated strategy for responding to each new requirement while continuing to excel at their day-to-day operations. A strong, adaptable regulatory response mechanism is critical in minimizing the potential impacts on both clients and the organization while balancing risk at the same time.

Reacting to each change or issue as it arises only ensures compliance with that specific requirement. In the current regulatory environment, where new regulations are introduced with unprecedented frequency, the effort required to separately comply with and respond to each discrete requirement can put increased pressure on an organization’s already stretched resources. If approached disjointedly without consideration of current processes, each additional requirement can impede existing controls and procedures and impact the overall customer experience.

Establishing an effective tax governance framework that is fully integrated and aligned with the overall governance framework is key. This will allow the organization to strategically partner with the tax function to proactively identify and respond to new requirements while developing organization-wide controls and response procedures. Such a framework incorporates the governance of specific projects and transactions as well as day-to-day tax operations, enabling compliance with both new obligations and ongoing requirements. A strong tax governance framework leverages the tax function as a true strategic business partner, actively involved in the identification and implementation of requirements and regularly collaborating with compliance teams and affected lines of business across the organization.

This paper explores the concept of tax governance as the ultimate compliance solution, looking at challenges in the current tax environment and tracing the three key components of an effective tax governance framework:

• Solution development;
• Implementation;
• Compliance governance.
The challenging tax environment

Globally, tax rules and regulations are in a period of flux. Changes are impacting organizations across all industries and in all countries, resulting in an evolving, borderless tax information sharing structure.

Cross-border transaction reporting
Several countries, including the U.S., the UK, France and Canada, have heightened the levels of reporting and documentation required in respect of cross-border transactions and payments. These new rules affect all corporations involved in cross-border transactions; in particular, this will result in a substantial increase in the compliance and reporting burden felt by financial institutions (FIs).

One such complex and stringent set of cross-border reporting requirements is the U.S. Foreign Account Tax Compliance Act (FATCA). Non-compliance can result in severe reputational and financial consequences for counterparties and clients alike, as well as increased levels of withholding tax liabilities, penalties, interest charges and information reporting requirements. Other countries are also embarking on similar FATCA-like tax withholding and reporting initiatives that may present additional reporting requirements for global FIs in the future.

Additionally, significant changes to other reporting and compliance requirements are on the horizon, including anti-money laundering (AML) and know-your-client (KYC) procedures; fund transfer reporting; collection of Canadian non-resident certifications; and requirements under U.S. Dodd-Frank legislation. Although each of these regulations has different underlying rationales, they all have something in common – they require the collection and retention of client data.

Organizations are just beginning to realize that FATCA reaches well outside the tax world into all business areas, including their customer base. Even though Inter-Governmental Agreements (IGAs) regarding FATCA are being negotiated with the U.S. Department of Treasury, compliance cannot be avoided. Canada is expected to adopt the first of two model IGAs issued by the U.S. Department of Treasury. Once adopted, the obligations under FATCA will become part of local Canadian law, enforced by the Canada Revenue Agency (CRA). Other countries and jurisdictions will choose whether to sign an IGA or compliance agreements with the U.S. Internal Revenue Agency (IRS) under U.S. domestic regulations. The overall compliance process and the appropriate treatment of local country entities and products may vary depending upon the type of IGA signed (or not signed), as well as country-specific exceptions.

All these factors result in a unique situation where organization-wide global compliance with FATCA may require an FI to report directly to the IRS for some jurisdictions while also reporting to a multitude of different local government and tax authorities in other jurisdictions. In most countries, both the local country tax authority and the IRS will play a part in governing compliance and overseeing enforcement.

Tax authority methodologies and processes
Concurrent with these changes in tax compliance and reporting requirements, global tax authorities are continuously monitoring, reviewing and updating their methodologies and processes for interacting with taxpayers and reporting agents, including FIs. Recently, this has resulted in several tax authorities – including the Australian Tax Office (ATO), Her Majesty’s Revenue and Customs (HMRC) in the UK and the CRA in Canada – adopting risk-based audit methodologies. Expanding their scope to incorporate not only a review of the tax technical and compliance history of taxpayers but also the level to which organizations integrate overall enterprise-wide risk management and governance frameworks with tax risk management and tax governance frameworks.

In this environment, it’s more important than ever that organizations have a robust and effective tax governance framework in place, not only to govern the development and implementation of their compliance response solution, but also to govern ongoing compliance with each individual requirement. This framework should monitor compliance and potential risks through documentation and attestation, responding to both local and global requirements.
Proactive governance underpins any successful tax compliance response solution. However, to be truly valuable to the organization, this governance must start at project inception. A robust, transparent and effectively communicated governance structure enables organizations to successfully develop and implement an efficient, innovative and flexible solution for responding to current and future requirements. A number of different governance structures can be employed to ensure that the development, implementation and ongoing execution of any solution runs smoothly. In all options, strong governance, controls and multidisciplinary teams are critical factors. Options include:

**Process-led**
Implementation is aligned by major process across all lines of business with a consistent, organization-wide approach.

**Business-led**
Implementation is aligned by business unit, enabling the organization to reflect client considerations directly.

**Geography-led**
Implementation is aligned by jurisdiction, helping the organization adapt to local practices, legislation, regulations and requirements.
There is no “one-size-fits-all” governance structure applicable and appropriate for all projects and all organizations. Each alternative should be reviewed and considered on a project-by-project, issue-by-issue, and/or organization-by-organization basis to determine which is most appropriate. Whether the solution is based on process, business or geography, it’s vital that certain key components are included in the final governing structure. Among those components are the following:

**Project sponsor**
As the link between the solution’s management, implementation and execution teams and the organization’s senior management, the project sponsor is responsible for aligning the solution with overall organizational strategy and objectives. The project sponsor is ultimately accountable for – and absolutely critical to – project success.

**Resources**
Resources must be identified based not only on short-term availability but also on the project’s long-term requirements. Resources with relevant and required skill sets, capabilities and cross-functional expertise are critical to the effective, efficient and accurate implementation and execution of the solution. A lack of appropriate resources impacts not only implementation but also the organization’s ultimate ability to respond to and comply with underlying requirements.

**Project management**
This, of course, involves immediate project management surrounding implementation, but it also means developing policies, controls and performance management methods and strategies for the future. These will enable the organization to optimize the solution’s long-term value by: reducing the costs associated with implementation and ongoing compliance; minimizing financial, reputational, non-compliance and other risks; and improving the potential for ongoing success and compliance.

**Communication**
Frequent and transparent communication with all stakeholders involved in and impacted by the solution and its underlying requirements is crucial to the ongoing execution process. Moreover, stakeholders who understand the solution’s benefits as well as the risks of non-compliance are more likely to work together to ensure success.
Successfully responding to regulations such as FATCA impacts processes and workflows throughout the organization. It requires input from and collaboration with numerous organizational areas, including IT, business operations, tax, legal and internal audit.

The impact of compliance on customers should also be considered. Despite these broad implications, solution success requires that all affected stakeholders participate in all of the following key elements of change implementation:

**Figure 1 – Key elements of change implementation**

1. **Assessment**
   - Identify similarities between the solution and existing activities to leverage efficiencies, simplify analysis and identify high-impact areas. Governance and oversight required by the tax function, as well as other functions, should be identified.

   During the initial assessment phase, the project sponsor must work with identified stakeholders in all impacted areas to develop the goals and objectives that will shape control parameters. These should include tax function participation in strategy as well as selective oversight within the larger governance structure.

2. **Solution development**
   - Incorporate existing capabilities and leverage current ongoing initiatives to optimize synergies. Effective governance structures should help the organization identify synergies between new and existing controls and certification solutions and possibly reduce the additional processes, systems and workflows required to comply with new requirements.

   Currently, each tax jurisdiction has robust documentation compilation and retention requirements to support tax compliance. However, each new tax regulation and legislative measure alters and increases existing required...
No matter which compliance model is used, ongoing tax interpretation requires tax to be fully integrated within the governance and compliance structure. This helps ensure appropriate due diligence around the requirements of each relevant tax authority.

documentation and reporting levels, in turn increasing the organizational burden. For example, FATCA documentation and reporting requirements are being considered by more countries globally, and local AML and KYC rules are becoming more stringent. As additional requirements are effectively met, organizations should be able to streamline compliance and controls around multiple regulations into one single methodology, reducing the overall compliance burden and cost.

An additional step in the solution phase is the development of a governance structure and compliance blueprint, which will enable proactive oversight of tax and/or information reporting processes and effective response to additional questions from the various enforcement agencies.

### Implementation
Actively governed implementation can enhance organizational value by minimizing costs, limiting adverse impacts on business operations and mitigating risks to customers.

Tax-based risk and compliance requirements identified during the solution development phase will impact processes and workflows across the entire organization. While the back-office functions are responsible for monitoring and managing compliance with the relevant authorities, customer-facing business operations – responsible for maintaining positive client relationships – must ensure clients are aware of potential implications and collect required information.

### Tax interpretation
Effective collaboration with tax specialists at each stage, from assessment through implementation, supports the identification and application of tax data collection and reporting requirements to business operations.

No matter which compliance model is used, ongoing tax interpretation requires tax to be fully integrated within the governance and compliance structure. This helps ensure appropriate due diligence around the requirements of each relevant tax authority.

### Governance and program management
Assessment, solution development and implementation will trigger projects across lines of business that should be coordinated centrally. For example, the requirements under FATCA and Canadian non-resident certificates must be considered and identified within all client contracts – at the initial inception of the transaction – to ensure that each party is aware of the potential implications. As such, additionally triggered projects should incorporate a review and enhancement of the processes and procedures undertaken by the legal function and compliance team when implementing contracts and undertaking existing AML and KYC procedures. Furthermore, any changes within the organization’s business operations must be analyzed to ensure that compliance impacts are appropriately identified and addressed in a timely manner.
Governing compliance

After implementing each required solution, organizations require robust integrated corporate and tax governance structures to ensure ongoing monitoring and maintenance; enhance transparency and accountability; and prevent day-to-day compliance falling offside. Specific governance activities undertaken by the tax function and the overall organization will rely not only on applicable legislation and regulations, but also on the organization’s risk attitude and profile.

Robust tax governance practices encompass the “tone at the top” and define the tax objectives and the basis on which tax risk should be addressed. These should be reviewed in the context of the changing tax and regulatory environment to ensure that the tax function can achieve an effective balance between value protection and value creation activities. A review should result in policies, procedures and internal controls that align with the overall organization’s current strategic plan.

Compliance governance includes:

**Tax strategy**
Aligning the strategy and objectives of the tax function with those of the overall organization helps the tax function effectively identify and deliver value while continuing to comply with underlying legislative and regulatory requirements.

The tax strategy must be formally documented and approved “at the top of the house” and it must also be communicated to all relevant stakeholders to ensure that “bottom-up” activities are effectively aligned.

**Risk policy**
The organization’s risk policy defines the level of risk the organization is willing to accept when completing each activity. A formal and documented tax function risk policy aligned with the organizational risk policy ensures that tax resources are effectively employed completing activities that will optimize the tax function’s overall value to the organization.

**Tax control framework**
This supports the tax function in managing tax risks, identifying tax opportunities and integrating governance policies, internal controls and tax processes to achieve strong tax risk management that aligns with the established risk policy. A tax control framework should include:

- Identification and documentation of key internal controls in place to monitor, manage and mitigate risks arising from financial reporting, tax compliance and other tax activities;
- Periodic assessment of tax risks facing the organization, including internal and external environmental matters; and
- Identification of processes and tools needed to effectively align tax function resources and activities with the organization’s overall aims and objectives.

A review should result in policies, procedures and internal controls that align with the overall organization’s current strategic plan.
Tax governance as the ultimate compliance solution

Current increased FI reporting obligations along with the move toward risk-based reviews and audits by regulatory bodies and tax authorities are pushing organizations to build their compliance response capabilities. They need an efficient, flexible, cost-effective approach to implementing required controls and processes and ensuring ongoing, timely compliance. Achieving this – with minimal impact to clients – is a critical risk strategy for today’s organizations.

It’s true there is no “one-size-fits-all” solution; however, a robust tax governance framework will increase your tax function’s ability to proactively respond – on a project-by-project basis – to the challenges of today’s dynamic and evolving compliance and reporting environment. When integrated with the broader organizational strategy, such a framework positions you to succeed both now and in the future – the “ultimate” compliance solution.

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