

Risk Angles

Five questions on the impact of tax risk

An interview with **Alan Macpherson**, Global Governance, Risk and Compliance Tax Leader, Deloitte Touche Tohmatsu Limited, and closer look by **Chris Tragheim**, Europe, Middle East and Africa (EMEA) Leader for the Foreign Account Tax Compliance Act (FATCA), Deloitte Touche Tohmatsu Limited.

An increasing interest in corporate taxation by the public and the media, and the creation of new tax-focused laws, such as FATCA, are prompting the C-Suite, boards and committees, and shareholders to take note — with good reason. Along with the uncertainty about how the tax system will respond to continued globalization of business, there are tremendous risks associated with corporate taxation. These risks range from major financial penalties and sanctions to reputational and customer-related risks.

In this issue of Risk Angles, Alan Macpherson answers five questions about the growing concern over tax risk, and Chris Tragheim examines one of the drivers of that concern, FATCA.



Question	Alan's take
What's behind the increased attention on corporate taxes by the public and media?	A big reason for the heightened focus on corporate taxation is related to government belt-tightening in the wake of the economic downturn and sluggish recovery. As governments claim they are forced to cut public services and entitlement programs due to declining revenues, media, the public, politicians, and candidates have begun questioning whether corporations are paying their fair share. Major global companies have come under considerable scrutiny and attack for their tax practices, such as operating in tax havens or having aggressive tax planning strategies. Though these practices are legal, negative public opinion has had a significant reputational impact on these companies.
Is anything beyond public opinion fueling the concern over tax risk?	Yes, adding to the concern about tax risk is the uncertainty about how the tax system will respond to the continued globalization of business and how companies might be taxed differently in the future. For example, many companies have adopted a global operating strategy that involves having different functions in different countries — not solely for tax reasons, but tax is typically one of the considerations. They may, for example, be headquartered in one location, have production facilities in a different location, an Internet business where customers buy goods in another location, and a fulfillment center in yet another location. So, their whole supply chain and selling operation may be arranged at least partly with tax in mind. If tax rules change, it could impact their entire structure and operating method, thus presenting major strategic risk potential.
How have companies treated tax risk in the past?	Thinking about tax risk may be new ground for some companies, as tax issues have often traditionally been seen as the purview of the company's "tax experts" and not widely embraced by executives. Now, with so much attention focused on tax, executives are taking note. Being seen as a somewhat "new" or emerging risk further elevates tax as a top-of-mind concern for the C-Suite.
How should companies be thinking about tax risk today?	Today's reality is that the potential impact of tax risk and tax changes reaches far beyond the tax department. Governments worldwide are already starting to adopt legislation such as FATCA and similar actions to more closely monitor the accuracy and completeness of individual and corporate tax reporting. Consider, for example, new obligations for financial institutions to report transactions that were previously solely their customers' responsibility to report. Media-fueled public perception of fairness and "the right thing to do" is also riding high. So even if tax concerns are not pressing for some companies at the moment, they could be in the future, and it behooves companies to be prepared.

What does "being prepared" look like?

You'll want to apply the same rigor and discipline to addressing tax risk as you do any other possibly impactful strategic risk, whether financial, reputational, or conduct-related. Preparation begins by first understanding what the tax risks are for your company today, and then looking at what emerging challenges may lie in future, what mitigating frameworks you might put in place as a result, and how tax changes could impact your overarching business strategy. If you find that tax isn't currently a contributing factor to the way the business strategy is developed, then you should recognize that tax may indeed have a place in business strategy going forward, both as a result of changes to the law and from changes in people's perception of corporate responsibility and fair play. Part of preparation is working through potential "what if" scenarios, so if the scenario comes to pass, you're ready to deal with it.

A closer look: FATCA

by Chris Tragheim

The U.S. Foreign Account Tax Compliance Act (FATCA) grew out of the perception that individuals and companies were using overseas bank accounts to avoid paying U.S. taxes. Passed in 2010, FATCA requires essentially all foreign financial institutions (FFIs) and certain non-financial foreign entities to identify US persons on an annual basis. The details will either be reported direct to the IRS or through Inter-Governmental Agreements which are currently being signed with the US. Moreover, in certain circumstances, FFIs and U.S. withholding agents are required to withhold 30% from payments (generally income from interest and dividends) made to individuals, FFIs, and Non-financial Foreign Entities (NFFEs) that are not in compliance with FATCA requirements. The effort is expected to raise US\$7.6 billion in tax revenue over a 10-year period.

Since FATCA, other countries have passed similar legislation. Dubbed "Son of FATCA," the UK's new Regulations affects UK Crown Dependencies (Guernsey, Jersey, and the Isle of Man) and overseas territories (Cayman Islands, Gibraltar and Bermuda, among others) and requires account controlled by British residents to be reported to the HMRC. More broadly, the OECD (Organisation for Economic Co-operation and Development) spearheaded the Model Tax Convention, whereby countries around the world are likely to enter into bilateral agreements to report accounts held by each other's residents. Like FATCA, Son of FATCA takes effect July 1, 2014 while the OECD's initiative begins a year later.

At their core, these efforts are aimed at making sure people are paying the right amount of taxes to the right country at the right time. But this is proving extraordinarily complex to implement. From an operational perspective, FFIs and NFFEs alike face a tremendous outlay of resources to establish the data collection and reporting processes and supporting technology systems to comply under an aggressive timeline. From a risk perspective, organizations face a number of concerns. First is regulatory risk, as the new requirements shine a spotlight on an organization's compliance practices and open the door for inspections and the possibility of systems audits. A reputational risk component exists as well — no organization wants to be on the front page for lagging behind or shirking their responsibility to identify foreign citizens to facilitate tax compliance. Also of concern is customer-related risk — informing customers of the new requirements, questioning them about their citizenship, collecting documents, and conveying that such information will be shared across institutions is a delicate matter that calls for careful handling to avoid backlash.

Overall, there's a sense of uncertainty and unease among organizations about how the regulations will play out in practice, particularly because some of the guidelines and required documentation are still in flux. Organizations can help mitigate this uncertainty by prioritizing their efforts.

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