Bloomberg BNA

Daily Tax Report®

Information Reporting

Deloitte Tax's Matthew Cahill, Jensen Jacob and Jawad Ahmad write that FATCA and initiatives like it worldwide are forcing financial institutions to examine changes necessary in their global tax information reporting operating models. They say forward-thinking institutions are developing and implementing new operating models in advance of regulator-imposed obligations—and they urge stakeholders to gather key metrics and build a strong business case to obtain C-suite sponsorship.

Global Tax Information Reporting: Mitigating Tax Risk by Dismantling Organizational Silos and Implementing a New Target Operating Model

BY MATTHEW CAHILL, JENSEN JACOB AND JAWAD AHMAD

Financial institutions (FIs) are facing significant and complex legislative and regulatory changes, leading to additional due diligence, withholding and reporting obligations as a result of the U.S. Foreign Account Tax Compliance Act (FATCA), similar provisions for the U.K.'s crown dependencies and overseas territories (UK-CDOT) and the Organization for Economic Cooperation and Development's Common Reporting Standard (CRS).

Together, these models of tax transparency are known as automatic exchange of information (AEOI) regimes. As they come to terms with what is required, FIs are recognizing that they are operating a patchwork of processes for tax information reporting across largely decentralized business units characterized by duplicative, costly and inconsistently used technology. To meet these escalating tax information reporting demands, forward thinking FIs are adopting a strategic approach and redesigning their global tax information reporting (GTIR) operating models.

Matthew Cahill is a partner and leader of Deloitte's Global Information Reporting practice, Deloitte Tax LLP; Jensen Jacob is a senior manager, Deloitte Tax LLP; and Jawad Ahmad is a manager, Deloitte Tax LLP.

Drivers for New Tax Transparency Regimes, Rise of the Prevailing GTIR Operating Model

To understand the challenges that exist today, it is helpful to revisit the origins of the existing environment. The global trend toward tax transparency is intent on minimizing tax avoidance and evasion.

To governments, and the vast majority of their electorate, adherence to one or more of the AEOI regimes, and leveraging the information obtained to raise tax revenue is a sensible approach to closing ever increasing budget gaps. It is therefore no surprise that there is considerable global convergence around this agenda.

However, many of the FIs that are to play a significant role in implementing these new requirements are doing so with limited resources and face operational and compliance risks as a result.

The operational risks arise, in part, from the decentralized environment in whichFIs currently operate. The FI's business units generally silo their resources and deploy separate people, processes and technology for customer tax onboarding, withholding and reporting activities. To some degree, this culture has arisen in the context of decades of mergers and acquisitions by and among financial institutions that were reluctant, for a myriad of reasons, to standardize processes across merged or acquired entities.

The compliance risk is directly associated with the operational diversity, complexity and variety of tax regimes' compliance requirements. Given where this new transparency paradigm sits on the political agenda, FIs found to be in breach should expect to suffer the reputational—and share price—consequences of regulators and media outlets publicizing lapses, penalties and actions taken against noncompliant institutions.

Challenges, Pitfalls of the Prevailing Model And Development of a New GTIR Model

Not surprisingly, FIs have been facing challenges in the new environment throughout the customer life cycle from the onboarding of new customers through to reporting customer tax information to the tax authorities.

At the start of the process the FI is required to collect and validate the customers' tax documentation. During this phase, typical shortcomings include failing to collect the correct paperwork or relying on forms that are invalid, not properly establishing beneficial ownership in the case of intermediary or flow-through entities, granting treaty benefits inappropriately and generally insufficient due diligence in comparing tax forms to account information (including anti-money-laundering/know-your-customer documentation).

After a client is onboarded, during payment processing, certain FIs are failing to identify reportable payments and properly calculate and report cost basis. Within the withholding process, some FIs are either failing to withhold, or calculate the withholding taxes incorrectly (in some cases due to limited functionalities within a system), and then failing to timely deposit taxes withheld to the Internal Revenue Service.

When it comes to generating the information and filing the returns, the failures in the previous three phases of the process typically result in inaccurate and incomplete reporting, which may be further compounded by systems lacking the ability to support the new AEOI regimes.

Failing to improve an institution's approach to GTIR increases risk. The penalty regime is severe, and the reputational impact of being seen as a party, or indifferent, to tax evasion has already been seen to have potential for large-scale negative financial consequences.

Given the opportunity to build a new model, many FIs might conclude that model would differ from their existing model. The good news is that others have begun considering, with varying degrees of intensity, the development and implementation of a new target operating model (TOM) and have concluded—even among large, complex organizations—that this is a reasonable and attainable objective.

A TOM not only allows FIs to comply with the new regimes, but brings with it operating efficiencies and the opportunity to enhance the overall customer experience.

What to Consider in Developing A New Target Operating Model

In smaller or simpler FIs with less geographical reach—both in terms of presence and customers—it may be possible to overcome the challenges of the new environment with limited changes to people, processes and technology. Improved training, more robust governance and some standardization may suffice. Larger FIs with more business units and a geographically diverse operating and customer base, may need to go further than this and develop a model that supports their footprint.

Those who have already embarked on this transformation are determining how far they can move the needle toward centralization, and in some cases a logical extension of this exercise is to outsource a portion of the operational activities to third parties if the allocation of risk and liability are appropriately addressed.

The extent to which FIs are able to centralize is dictated in part by budget, ambition, product diversity and C-suite sponsorship, but institutions may also have good reasons to remain with multiple owners of tax processes and business units with some level of distinctness to their processes. Reasons for pulling back from full centralization may include the acknowledgement that certain business unit customers may be negatively impacted without slight variations to the newly adopted standard processes, or recognition that the benefit of centralization is outweighed by the cost.

The strategic areas of focus for a new TOM should be:

■ **Enhancing the onboarding process with an online form validation tool to validate tax documentation in real time.** To meet the new and escalating demands, FIs are using tools such as a Web-based ''customer portal'' where tax documentation can be completed online with integrated functionality to validate tax forms in real time or in batches, supported by center of excellence (CoE) hubs to provide consistent process execution and onboarding spokes that leverage consistent technology to execute the process.

Priorities in Development of a New Info Reporting Target Operating Model

Strategic areas of focus for a new global tax information reporting target operating model should be:

■ enhancing the onboarding process with an online form validation tool to validate tax documentation in real time;

■ the development of a withholding tax engine to support complex withholding tax calculations;

■ automating and centralizing reporting via an enterprise reporting utility;

■ data management;

■ the establishment of one or more ''centers of excellence'' to drive enhancement and firmwide process consistency; and

■ a tax consulting and risk management function to provide tax advisory support and oversight.

ISSN 0092-6884

■ **The development of a withholding tax engine to support complex withholding tax calculations.** To reduce the complexity characterizing the current state in which each transaction system of record (SOR) is required to contain the functionality needed to identify and calculate withholding, FIs should consider developing and deploying a single withholding tax engine to perform withholding tax determinations using a consistent rule set (i.e., backup, nonresident alien (including treaty rate support), FATCA, I.R.C. Section 871(m)) for all SORs.

■ **Automating and centralizing reporting via an enterprise reporting utility.** Redundant reporting processes can be reduced through a single reporting facility utilizing a data hub to determine information to be reported, submit the reports, confirm receipt and resolve exceptions.

■ **Data management.** One of the challenges to making across-the-board improvements in the current environment is that each business unit—in addition to having its own people and its own technology—has its own SORs. In a new TOM, data management is a key component using a workflow tool that links the various dimensions, and a data hub that consolidates onboarding and data obtained from various SORs allowing improved validation, processing and reporting.

■ **The establishment of one or more CoEs to drive enhancement and firmwide process consistency.** Much can be achieved through the use of technology, however with requirements as complex as those arising from the enactment of the various AEOI regimes, the human element can't be discounted. Leveraging more efficient and enhanced processes with the leading available technology is the remit of knowledge-based CoEs, which facilitate ongoing enhancements and FI-wide consistency with supporting global hubs and spokes to balance process improvements with the pliability to support varying business units.

■ **A tax consulting and risk management function to provide tax advisory support and oversight.** The final aspect of an enhanced TOM is the network of global professionals providing tax consultancy experience and risk management capability to advise on the implementation of, and response to, the information reporting regimes as they evolve and assess the adequacy of controls across the life cycle from onboarding to reporting through to IRS audit oversight and management.

Beyond the characteristics of a new TOM, FIs also need to consider the time and cost implications, both of which can be significant.

Nevertheless the potential benefits of taking action can also be considerable, not least for the customer: Onboarding should become a once-only process thanks to real-time validation, their information reporting should be on time and accurate, automation of processes should allow more time for customer service at the business unit level, and consolidated tax notices for all business units and sharing of tax forms should reduce the number of customer touch points needed.

C-Suite Sponsorship: Why You Need It and How to Get It

The AEOI regimes in themselves have attracted less executive-level interest than necessary to effect the widespread scale of change that FIs should undertake. The majority of FIs that have taken steps toward a new TOM have been driven to do so by the IRS or by pressure from their internal/external auditors who are testing and reviewing information reporting processes and identifying gaps leading to ''real'' Accounting Standards Codification 450-20 (commonly referred to as Financial Accounting Standard 5) financial statement impacts for noncompliance.[1]

FIs have had time to acclimate to the implications of FATCA, however FATCA began to expose gaps in existing Chapters 3 (nonresident alien) and 61 (Form 1099/ backup withholding) information reporting processes. The U.K. added a level of complexity by imposing similar reporting obligations on some FIs with its UK-CDOT regime. However, the CRS has changed the landscape again, significantly and—from the perspective of those with responsibility for customer tax information gathering, processing and reporting[2]—not for the better.

The AEOI regimes in themselves have attracted less executive-level interest than necessary to effect the widespread scale of change that FIs should undertake.

The CRS requires an exponential increase in effort, not least because it is a minimum standard so the requirements may differ significantly across jurisdictions as each participating jurisdiction adopts the standard and issues its guidance.

Stakeholders in these processes need to position these changes on the C-suite agenda before regulators force the needed changes, exact financial consequences and potentially mandate the manner and timeline for the implementation of their changes. To immediately begin proactive positioning, it is incumbent on stakeholders to build a fact-specific business case using key metrics across business units, including onboarding volumes, withholding amounts and number of filings for reporting purposes, which together allow for the calculation of firmwide exposures. Of course, the necessary care needs to be taken in protecting such analysis with distribution only to those with the appropriate privilege.

These key metrics, when combined with the total operating cost of the current operating model, equate to the cost of not taking action—current risk exposure plus current operating cost. By moving to a partially or wholly centralized model, the mitigated risk of error and operating efficiencies (less the cost to implement) represent the return on investment on the new TOM when compared to current cost.

Of equal importance, though harder to quantify, is the positive impact that the new TOM has on the overall customer experience. The improvement of the cus-

[1] FASB ASC 450-20-25-2.

[2] Kuepper, Karl. ''Germany: FATCA 3.0: The introduction of a global standard on automatic exchange of tax information,'' International Tax Review, http://www.internationaltaxreview.com, June 17, 2014.

tomer experience is an important guiding principle to maintain throughout the journey as the new process is planned and designed—''what does this mean for the customer?'' Ideally, it provides a reduction in the number of touch points for the customer by aligning processes, and added value through greater accuracy of data in client master files with an elimination of redundant and/or unnecessary customer interactions that often result in significant customer dissatisfaction.

Lessons Learned From Early Adopters

For an effective outcome, it is obvious that FIs require full cooperation and participation from core tax practitioners. However, successful change of the magnitude needed to address the demands of this rapidly shifting landscape requires engagement of finance, operations, business unit leadership, change management, technology, risk and compliance from the outset.

Key to business unit and stakeholder alignment is a dedicated senior C-suite executive to effectively keep the initiative on track and manage the change consistently across the institution.

Those FIs that have started to effectively move to a TOM fit for this new environment have learned that:

- Although the drive for an enhanced process is important, the critical dimension to consider is the customer experience—FIs need to reduce the additional burden of the new AEOI regimes on the customer and when possible this exercise in enhancement should be used as an opportunity to streamline end-to-end global tax information reporting processes and enhance the overall customer experience.
- C-suite executive buy-in should be obtained early and sponsors should be engaged often to escalate challenges and obtain feedback during the design phase.
- The key to C-suite buy-in is a powerful business case. As described above, such a case is dependent on gathering key metrics including payment volumes, customer volumes, historical penalties and corrections (both internal and from the market).
- Including existing tax operations personnel in the planning and design phases drives buy-in and gives firsthand insight into the practical, frontline challenges to compliance.
- Business units will have in-flight operational processes that need to be supported as they move to the new processes in parallel to their existing processes.
- Timing the involvement of third-party vendors as part of the design phase needs careful consideration. Thinking through this process puts an FI in a better position to align the new TOM to vendor solutions, and allows an FI to be in a stronger position for negotiating solutions with vendors.
- To facilitate acceptance across the stakeholder community, it is essential to establish a change management workstream early to provide regular updates, recognize effort and share successes and lessons learned.

The challenges presented by FATCA, UK-CDOT and the CRS are significant, but not insurmountable; the technology and advisory experience exists to guide FIs through the legislative and regulatory landscape to a new TOM that is fit for purpose and adaptable to further changes. However, the regimes are already live, so the time to act is now.

  DTR ISSN 0092-6884