

# Tax Risk Management: From Risk to Opportunity

## Tax Control Framework

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*This chapter is based on information available up to 1 November 2009.*

### 1. From risk management to opportunity management

This chapter describes the key elements of a tax control framework (TCF) and how such a framework is to be built. In this respect one should realize that there is no “one size fits all” TCF. Each TCF needs to be custom built to the specific needs of the organization and taking into account the specific DNA of that organization. Nevertheless, when building a TCF there are a number of generic elements both in process and building blocks that apply to each TCF.

In this chapter we will try to provide insight into the aspects of constructing a TCF tailored to your organization and these “common elements” so you can use this as a benchmark to your TCF or as a starting position for building your own TCF. The first part will provide an overview of the terms and definitions used, and a first introduction into the background of tax control. Next, the construction of a TCF will be described. This part provides an overview of the building blocks of a TCF. It provides a description on all the building blocks needed to build and construct a TCF (see 3.). The following paragraph addresses the cultural and organization context of tax control (see 4.). The last paragraph suggests how to get started with the introduction of a TCF and to get in control of tax risks (see 5.).

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### 3. Building the tax control framework

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#### 3.7. Organization and resources

This part will address the following topics:

- (a) organizational resources; and
- (b) questions to ask.

##### (a) *Organizational resources*

People are the cornerstone of any tax function and ensuring they have the right skills, knowledge, motivation and tools is fundamental to the management of tax and minimizing risk.

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The challenge for organizations is to ensure the right level and balance of resources given the available budget. To enable effective resource management, some tax departments are focusing on the following four elements to achieve the required levels of performance and quality while balancing cost constraints:

- Management. Tax directors need to focus on giving the right work to the right people. This will enable a balanced workload that should be consistent with the wider organization's operating strategy.
- Skills utilization. Allocate specific tax work to those staff that have the necessary tax technical background and skills to undertake that work. Often, tax directors fail to recognize the extent of areas where an activity requires technical skills or experience that is not tax-related. Where this is the case, tax directors can benefit from contracting that work outside of the tax function.
- Incentivize. Tax personnel should have clear job descriptions, attainable opportunities for career progression, and a development and training plan. Of course, remuneration is also important and these attributes will ensure that the organization can attract and retain the best tax people.
- Motivate. Ownership and pride in the work carried out by tax personnel is important. A main risk area for the tax director is to unwittingly create a working environment which engenders monotony, career stagnation or a sense of unrewarded effort. This can readily be resolved by including staff in meetings, providing clear communication channels for feedback and discussion, providing achievable goals that challenge the individual, delegating effectively and building trust.

Of course, many tax directors also look outside their immediate function for skills and resources. Equal benefits can be leveraged by alternative resourcing options such as outsourcing, use of shared services centres and external technical consultants.

The important issue for the tax director however is to try and ensure there is a consistency in the skills and resources used to manage tax in the organization. Loss of knowledge and expertise of a company's tax processes and controls (especially when these may be opaque) is a significant risk.

*(b) Questions to ask*

- Do we have the right tax competencies in the organization?
- Do we have enough skilled tax personnel in our organization?
- Do we have assurance on the continuity of our tax department?
- Do we have access to external expertise in a timely manner?
- Do we have enough budget to reach our tax goals, considering the tasks and responsibilities assigned to our tax department?

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## **5. How to get started**

Tax risk management covers the identification of business risks originating from the tax position of a company and identifies ways to manage these risks. The identification, implementation and maintenance of risk management and supporting systems should be done in three phases. The first phase includes a zero measurement in which the organization identifies its key risks. The second phase includes the implementation of a TCF to mitigate these risks. The third phase is the maintenance phase in which the organization is in control of its tax risks and updates the framework when necessary. These phases will be described in more detail in the next paragraph.

Apart from the execution of the tax risk management method during these phases, the organization should also consider communication and cooperation with the tax authorities. Building a good relationship with the tax authorities will speed up and improve the tax filing process in the future. Transparency about tax risks is also a way to improve good communication with the tax authorities and assures control on uncertain tax positions. The implementation of a TCF could enable insight and control of these positions.

### **5.1. Blueprint TCF**

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#### *Phase I: Zero measurement*

Based on interviews, an initial list of risks is identified. Important in this process is the explicit definition of a risk in order to create a common understanding of the risks discussed. The overview of identified risks contains all tax risks which can be identified for the organization, but not all risks can be acted upon because of time and resource constraints. Acting upon every conceivable risk is not a necessity because not all risks have the same urgency to be solved. To identify the key risks of the organization, the risks need to be rated and prioritized. The risks will be rated on “impact” and “preparedness”. These concepts will be explained next.

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#### *Phase II: Implementation*

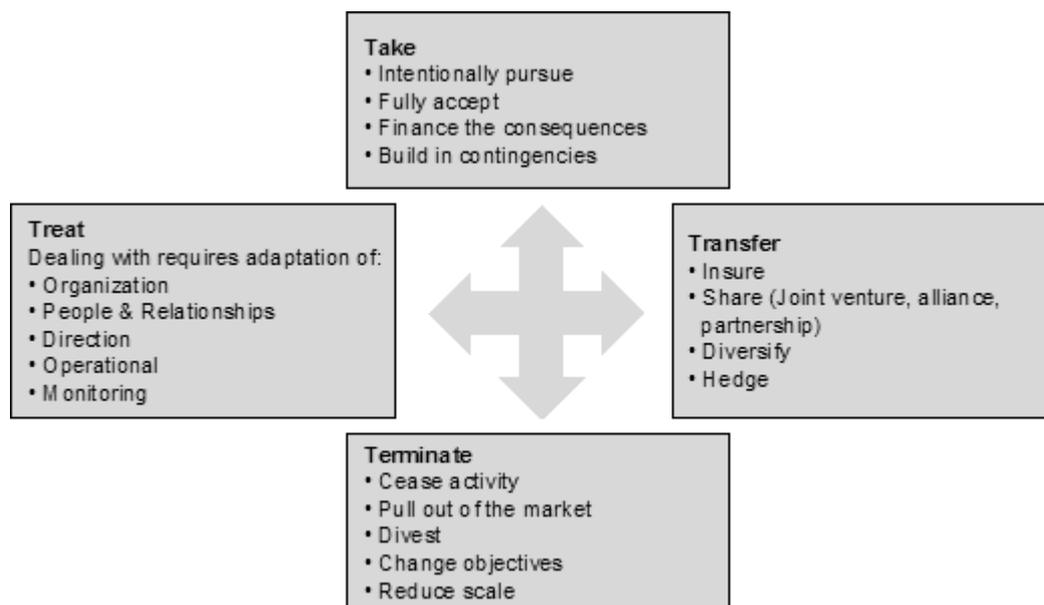
In this phase, the risk register will be introduced. In a risk register, the assessed risks from the previous phase can be documented. The risk register is a means to communicate the key risks to the management of the organization.

The risk register is a central place where the identified risks are schematically presented. It contains KPIs which are relevant to the organization. A risk register, for example, consists of the following labels: number, name of the risk, risk definition, cause for the risk to occur, risk category and the risk owner.

After the creation of the risk register, the identified risks must be analysed to create a plan on how to mitigate them going forward. The organization should also identify if additional (key) controls should be implemented to mitigate the risks. This analysis should be added to the risk register by formulating an action plan, evaluation of a risk profile and integration with the strategic planning process.

For each risk, an assessment is made on how to approach the risk. There are four generic actions an organization could take, identified in the diagram below:

Picture 1: Four ways to approach tax risks



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### *Phase III: Test and use*

When the controls are defined by the risk owners, they should be tested in practice. A central question in this process is whether the controls are effective. This also relates directly to the control objectives. The controls are tested to prove their working and mitigating effects.

In line with the risk register, the risk owners will do the testing of the appointed controls. The method of assessment of whether the control is effective is a management decision. A solution could be to carry out the physical testing of the control, but a control self-assessment or similar testing is also a solution.

The first step in control testing is to identify the existence of a control and how it is set up. The next step could be to test the working of the control and whether it indeed covers the related risk. The test results could be used to reconsider the approach towards existing risks.

To improve transparency about the status of identified top risks and the overall risk profile, the organization could use a TCF report. The TCF report is a means to

monitor the risk profile of the organization and creates the ability to manage upcoming risks or the mitigation of existing risks.

## 5.2. Conclusion

In this chapter we have tried to provide you with a flavour of the common elements of a TCF. There are aspects that need to be addressed in each TCF, irrespective of the kind of organization. Although every organization is unique, every organization has a different business control framework, and therefore a different TCF, experience does show a TCF blueprint. The TCF blueprint items can be addressed along the lines of six building blocks:

Picture 2: The building blocks of a tax function



Ultimately, this should lead to a tax function which is embedded in the organization and which is effective, efficient and transparent.