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Tax Governance in focus

Advantages of a digital tax compliance management system



In the current market environment, ever more attention is being paid to Tax Governance – by investors, tax authorities as well as by the supervisory authorities.

The introduction of stricter sanctions in the case of non-compliance with tax obligations, rising transparency, documentation and reporting requirements, as well as the updating of taxation procedures, are evidence of this.

As part of the audit of the 2022 financial statements of asset management companies (AMCs), the German Federal Financial Supervisory Authority (BaFin) has defined an audit focus area for tax business structures.

Substance of the audit focus area and approach during an audit

The substance of the audit focus area was to verify whether and to what extent the AMC has a tax business structure that prevents the AMC

- from violating tax regulations on its own account or for assets under its management,
- thereby exposing itself to the risk of involvement in a tax criminal offence or subsequent claims being asserted by the tax authorities.

The review procedures carried out as part of the audit focus area are in line with IDW AsS 980 with its seven fundamental elements of a Tax Compliance Management System (Tax CMS). The assurance standard (AsS) of the German Institute of Public Auditors (Institut der Wirtschaftsprüfer (IDW) describes the requirements placed on a proper Tax CMS.

The objective of a Tax CMS includes ensuring tax compliance, which means satisfying tax obligations and avoiding non-compliance by providing exculpatory evidence to tax authorities.

IDW AsS 980 includes the core elements of a proper tax business structure of the company.

Documentation of the following fundamental elements of the Tax CMS was checked in accordance with IDW AsS 980. A test of the design and effectiveness was not within the scope of the audit.

1 Tax compliance culture

This includes the definition and documentation of measures to embed tax compliance in the corporate culture and involve the tax department when dealing with tax-relevant topics. Furthermore, it includes implementation of a sanctions system that is suited to disciplining violations related to tax compliance.

2 Tax compliance objectives

This fundamental element includes the definition of objectives for the tax function/Tax CMS and definition of a tax risk strategy.

3 Tax compliance organisation

Assignment of clear responsibilities and definition and documentation of the tax function's organisational and operational structure are key components of the Tax Compliance organisation. In addition, interfaces to the specialist departments – which are involved in tax processes – are defined.

4 Tax compliance risks

The identification, recording and evaluation of tax risks – taking into account the scope and nature of business activities – are key aspects of a Tax CMS. Risks are documented and assessed by means of a risk inventory.

5 Tax compliance programme

Measures to reduce existing tax risks are defined in this fundamental element. Measures include, for example, process documentation, policies/procedural instructions, IT-supported controls or the inclusion of tax advisors.

6 Tax compliance communication

This fundamental element deals with the definition and documentation of processes concerning internal and external reporting requirements and reporting channels (including reporting on tax risks). In addition, information is provided on the tax compliance programme/defined roles and responsibilities, as well as the instruction of affected staff on tax obligations.

7 Tax compliance monitoring and improvement

The final fundamental element includes the implementation of a systematic approach for monitoring the Tax CMS on a continuous basis/ monitoring the tax function and tax processes. In practice a regular check of the implemented Tax CMS is recommended.

The value of a Tax CMS

Effectively handling the challenge of being compliant necessitates clearly defined processes, where the tax department assumes a governance function – with instruction and control rights – and responsibility for efficient and transparent risk management. A Tax CMS that is appropriately designed and effective in practice contributes significantly to identifying and sustainably avoiding tax risks. As a result, it especially supports governing bodies in ensuring proper business management, the avoidance of losses and protects against claims being asserted against personally liable members of the governing body. In addition, a company improves its process transparency by intensively illuminating core tax processes and risks, which enables the optimisation of workflows and creates efficiency.

Advantages of a digital Tax CMS

Both the BaFin audit focus area as well as a wide range of practical experience show that Tax CMS implementation projects at many AMCs are still in the implementation phase. AMCs often have only limited staff available for implementing a Tax CMS and then rolling it out to regular operations.

This makes it all the more important to align the design of the Tax CMS with the company's requirements and general conditions already during the planning stage.

Especially relevant in this regard is that the processes and risks are an element of a Tax CMS not only on AMC level, but also on product level. Attention should be paid already in this step to ensuring that documentation is digital rather than analogue, so that it does not disappear in some drawer unused due to lack of practicability. Maintaining an analogue documented Tax CMS requires significant manual work that, combined with the increasing shortage of staff, cannot be implemented and no longer fits with advancing digitalisation in day-to-day operations.

Consequently, the recommendation can only be to implement a Tax CMS, where core tax processes, including responsibilities and interfaces, are linked to the risks and, furthermore, the risk-mitigating measures and controls derived from them are also included.

Firmly defined tax events can be used to automatically initiate follow-up processes. The execution of controls and system-generated documentation can be automated as well. Sending reminders along with firmly established escalation steps help to fulfil tax obligations on time while simultaneously reducing manual administrative work.

Furthermore, a digital Tax CMS can be integrated into the AMC's overarching process landscape and, thus, become an integral part of a comprehensive CMS.



Outlook:

Tax Governance and Tax Compliance are hot topics for the various different internal and external stakeholders of an asset management company and should be core elements of a comprehensive ESG strategy.

In the course of numerous Tax CMS projects, we have developed various approaches on how to implement a proper Tax Governance strategy, based on company size, staffing and complexity, together with our clients.

An effective digital Tax CMS reduces tax risks and improves the transparency of the core tax processes. This also makes it possible to identify more quickly changes in tax legislation and their impact on the business model. The tax function is thus able to respond to changes early and actively, thereby becoming a reliable business partner within an asset management company.



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