Directors’ Compliance Statement: Tax Aspects

Laura Heuston *Director, Tax, KPMG*
John Curry *Director, Tax Process & Technology, KPMG*
John O’Shea *Director, Legal Services, KPMG*

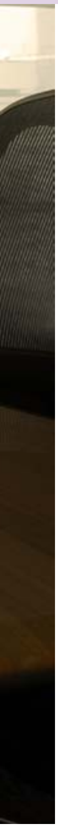
Overview

Under the Companies Act 2014, directors are required to include a Directors’ Compliance Statement (DCS) in the annual directors’ report. This new requirement reflects a recurring theme in the Act, being the concept of increased responsibility and accountability for directors.

The DCS itself is a statement to be included in the directors’ report in which the directors:

- acknowledge their responsibility for securing the company’s compliance with certain “relevant obligations” and
- confirm that certain assurance measures (“actions”) have been carried out or, if they have not, explain why not.

The relevant obligations include all obligations under Irish tax law (all tax heads) and certain obligations under the Companies Act 2014, a breach of which could give rise to serious criminal sanctions.



In relation to the relevant obligations, the directors must confirm that:

- the company has a compliance policy statement,
- arrangements and structures ("compliance processes") have been put in place to secure material compliance and
- an annual review of the compliance processes has been carried out during the year.

Both the compliance policy and the compliance processes should, in the opinion of the directors, be appropriate to the company. The compliance processes may include reliance on the advice of employees and service providers with the requisite knowledge and experience, but responsibility remains with the directors.

The new requirement applies to all Irish public limited companies (except Part 24 TCA 1997 investment companies) and other limited liability companies with a balance sheet total exceeding €12.5m and an annual turnover exceeding €25m and applies for accounting periods starting on or after 1 June 2015. It does not apply to unlimited companies or to companies formed under foreign law.

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Failure to include the statement of responsibility or a statement that assurance measures have been undertaken (or to explain, if not) in the directors' report carries a maximum personal fine for each of the directors of €5,000 and/or a maximum prison sentence of six months (summary conviction only).

The Global Context

The introduction of the DCS is aligned with the increasing global focus on corporate governance and risk management. In relation to tax, in particular, tax authorities are increasingly enquiring into tax governance, i.e. how the tax function fits into the wider business, what the key tax risks are and how tax compliance is managed and controlled. Tax authorities want to understand how the underlying data enters into and moves through the accounting systems, leading to the numbers that form the basis for completion of a tax return. The desire is to obtain assurance around both the completeness and the accuracy of the information included in tax returns and also ensures that their own (often scarce) resources are targeted at those companies that represent the greatest risk of non-compliance. There are numerous examples from around the globe of this trend, and developments in the UK and Australia are outlined below.

In 2009 the UK introduced the Senior Accounting Officer (SAO) provisions. These rules require a company within scope to identify its SAO, and they oblige this person to take reasonable steps to ensure that the company establishes and maintains appropriate "tax accounting arrangements" to allow tax liabilities to be calculated accurately in all material respects. The SAO is the director or officer of a company who has overall responsibility for the company's financial accounting arrangements. Similar to the Irish DCS legislation, there is a personal penalty for the SAO for failure to comply. The concepts involved are broadly similar to the DCS requirements.[1]

The Australian Tax Office (ATO) has also embraced the view that tax risk management must be a part of good corporate governance. In 2015 the ATO issued the Tax Risk Management and Governance Review Guide, outlining its expectations in this regard. The guide is not compulsory, but it emphasises the importance of the involvement of the board in managing tax risk.

A Suggested Approach

An approach to the DCS for directors and management to consider is shown in Fig. 1.

1 A key distinction from the DCS requirement is that the SAO requirements apply only to large companies, defined as those with a turnover of more than £200m and/or a relevant balance sheet total of more than £2bn for the preceding financial year. A further distinction is that the SAO rules are encoded in tax legislation, and therefore compliance with the rules is monitored by HMRC.

Figure 1: Next steps for directors – a suggested approach

Consider what Irish tax law and company law obligations are within scope for the company

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Review the existing tax and legal compliance governance and control framework

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Consider what level of board reporting already exists in relation to tax and legal compliance

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Consider what comfort the board will need in order to sign off on the Statement – bearing in mind subjectivity and materiality

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Discuss the requirement with management and agree a plan to ensure the desired level of comfort is obtained and the timeline for same

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Consider what type of board reporting will be put in place going forward in relation to the Directors' Compliance Statement

A company within scope of the new DCS provision clearly already has an obligation to be compliant with Irish tax law and should have an appropriate internal control framework in place to ensure that tax is calculated correctly and that tax returns and payments are filed on time.[2]

In many cases, little additional work may be required in relation to this framework, although documenting it may be helpful if that has not already been done. It must also be remembered that there is both a materiality test and a certain level of subjectivity included in the DCS provisions. That said, directors should in all cases consider the comfort that they will need to obtain in order to sign off on the DCS and to what extent their deliberations should be documented.

Tax Risk Management Tools and Methodologies

There are well-established tools and methodologies that can assist with the review of an existing tax and governance and control framework. However, once we enter this sphere, we are into a world of terms that can be (for some) opaque and offputting, e.g. governance and control frameworks, risk registers, process maps, monitoring, fit–gap analysis, walk-throughs and effectiveness testing. That said, once we cut through the jargon, these tools and methodologies are of huge value in relation to tax compliance in general and to meeting the requirements of the DCS in particular.[3] By way of illustration:

- A tax process map is just a flowchart. For example, in a VAT scenario, it maps who does what from the time an invoice is received from a supplier until the time the VAT return is prepared and submitted, showing the various individual or system steps that together make up the process to ensure that VAT is reclaimed appropriately on that invoice. It can be as complex or as simple as required for that particular company and can be used as a training aid and a succession plan where the people involved move on to other roles.
- A tax risk register is simply a single source document (it could be a spreadsheet) that lists the key tax risks in a consistent manner, helping to identify and manage risks before problems arise. It can be a means to improve processes and controls where risks have been highlighted and can be expanded to document the applicable controls. A tax risk register can provide an escalation framework that is set in line with the company's tax risk appetite and can be used as a high-level reporting tool to the board. For example, a key tax risk may be that the corporate finance team would raise debt without getting tax function sign-off before doing so, which may mean that a tax deduction is not available for the interest incurred on the debt. Depending on the company, a control in that scenario may be that the board requires that appropriate internal/external tax sign-off must be obtained before any corporate transaction will be approved by the board.
- Effectiveness testing would include the use of software to interrogate general ledger data to identify potential tax compliance issues for further review and investigation. For example, the software could extract a list of VAT invoices where no VAT was charged. A targeted review of these could be done to check whether they were received from abroad and were subjected to reverse-charge VAT, as appropriate, or

2 The OECD describes the tax control framework as the part of the system of internal control that assures the accuracy and completeness of the tax returns and disclosures made by an enterprise.

3 The HMRC SAO guidance and the ATO guidance provide further insight into what a tax control framework is in practice, as well as specific examples of the systems and processes that support the framework.

whether they were received from a domestic supplier and were VAT-exempt goods or services.

In summary, the tax control framework for any particular company will depend on such factors as the nature, scale and complexity of the company's business. Although there is no "one size fits all" approach, these established tools and methodologies can be used to review and enhance the existing framework and assess it against tax law requirements and best practice.

What Are Companies Doing?

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We have found that companies need assistance around the three actions required – the compliance policy, the compliance processes and the annual review. The scope of any project depends on the key questions summarised in Fig. 1: determining, first, what is there already and, then, what the directors feel is required in addition to obtain the comfort they need to include the DCS in the directors' report.

Compliance with Irish tax law is clearly broad in its scope. Companies are considering this in the context of their own facts and circumstances, as not all tax obligations will be relevant to every company. In our experience, companies are reviewing their position tax head by tax head, rather than trying to make a list of all relevant tax law obligations. In essence, the focus is on end-to-end tax compliance processes rather than on a check-the-box exercise.

Conclusion

Many companies are grappling with how to respond to the new requirement of the DCS that has been imposed on directors. The response required by directors will vary and will depend on factors such as the nature, scale and complexity of the company's business and the tax and legal framework in which it operates. Responding to the DCS requirement can open opportunities to increase board engagement and embed tax controls into the business, shifting the tax functions focus from compliance to adding real economic value to an organisation. While the way forward may seem unclear, taking a step-by-step approach that focuses on established tools and methodologies from the risk management sphere will get management well on the way to responding to directors requests in relation to the new requirement.

Read more on taxfind Section 225 Directors' compliance statement and related statement, Companies Act 2014