TAX RISK-MANAGEMENT ANALYSIS: COMPARISON BETWEEN THE UNITED STATES OF AMERICA, THE UNITED KINGDOM AND SOUTH AFRICA

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Received: September 2013
Accepted: May 2014

Abstract

Tax risk-management (TRM) is a little-studied area of corporate governance, despite the proliferation of ever more complex tax legislation that can have a material impact on the sustainability of organisations. In this light, the aim of this research is to explore policies and procedures relied on by tax authorities in the United States of America, the United Kingdom and South Africa to encourage a culture of compliance with tax laws. For this purpose, the research differentiates between specific and generic tax risks. These include transaction, operational, compliance, financial accounting, portfolio, management and reputation risk. The study highlights how each TRM-related policy or programme addresses these tax risks and compares the TRM systems in the three jurisdictions.

Keywords

Tax risk-management; risk-management plans; regulatory developments; governance developments; tax risks

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1. INTRODUCTION

Enron et al. led to a paradigm shift in American corporate governance (Canada, Kuhn & Sutton, 2008; Sy & Tinker, 2008). Gone was the belief in the all-mighty free market system. With the promulgation of the Sarbanes Oxley Act of 2002 (SOX, 2002), the world’s largest economy submitted to more government-backed regulation of its capital market system. Over 10 years later, the international community is again dealing with a financial crisis, questioning the adequacy of risk identification, management and curtailment policies (Gerding, 2009).

Few researchers have, however, considered the relevance of taxation as part of the change in the risk-management ethos. Tax remains a ‘resultant’ determined ‘simply’ by applying the applicable tax rate to the taxable incomes determined in accordance with the respective jurisdiction’s tax rules (International Accounting Standards Board (IASB), 2012). In the context of tumultuous financial markets (Witherell, 2012), rapid changes in domestic and international tax laws (Weinberger, Nolan & Thomas, 2012) and an increased propensity for tax authorities to engage in aggressive tax administration and collection policies (Weinberger et al., 2012), this perspective is no longer appropriate (Elgood, 2004). Tax risk-management (TRM) can have material implications for the ability of organisations to generate socially responsible and sustainable returns in the short, medium and long term, making it a highly relevant part of the corporate governance paradigm (Leitch, 2003; Elgood, 2004).

The emergence of integrated reporting supports this view. What is increasingly apparent is the need for a comprehensive system of risk identification and management that proactively addresses tax-related risks (consider Institute Of Directors (IOD), 2009; Integrated Reporting Committee of South Africa (IRC), 2011; Loots, 2012). This will need to take cognisance of the company’s overall commercial strategy, the potential impact on stakeholders and the need for enhanced transparency and accountability (Organisation for Economic Co-operation and Development (OECD), 2006). Prior corporate governance research has, however, largely ignored the importance of effective TRM (Demidenko & McNutt, 2010). As a result, this research carries out a detailed content analysis of the relevant tax literature in the United States of America (USA), the United Kingdom (UK) and South Africa. It provides a definition of TRM and a broad overview of how the compliance-enhancing practices and policies of the respective tax authorities have changed over the last 10 years.

In doing so, this paper makes an important contribution to corporate governance research by extending the understanding of regulatory developments and highlighting the ever-changing tax management frameworks used by each country’s revenue collector. It should, however, be stressed that this paper is exploratory and entirely discursive (as per Jones & Solomon, 2013). No effort is made to quantify the costs and benefits of various programmes or schemes introduced by the relevant tax authorities or TRM in general. This is largely due to the absence of direct prior research on TRM (see Brennan and Solomon, 2008). Further, in the interest of clarity the research does not examine specific tax-based risks and TRM controls at selected organisations. Instead the paper provides a broad conceptual account of TRM with the aim of informing subsequent research.

The remainder of this paper is structured as follows: section 2 focuses on the classification of the different tax risks which impact on organisations. Section 3 discusses how tax authorities in the USA, UK and South Africa have reacted to their country-specific TRM landscape with the introduction of compliance-enhancing policies and procedures, and briefly compares these.
Section 4 summarises the findings. It presents concluding remarks and identifies areas for additional research, as well as research limitations.

2. CLASSIFICATION OF TAX RISKS

Tax risks can be seen as either specific or generic (Elgood, 2004). The former are divided into transactional, operational, compliance and financial accounting risks, while generic risks include portfolio, management and reputational risks (Elgood, 2004; Bakker & Kloosterhof, 2010).

2.1. Tax-specific risks

Transactional risk is a measure of the probability that unusual or complex transactions give rise to structuring commercial arrangements to avoid the payment of tax or the misapplication of tax laws (consider Elgood, 2004; Bakker & Kloosterhof, 2010; Weinberger et al., 2012). For example, routine transactions, such as purchase and sale of inventory, are likely to result in a lower transaction risk. In contrast, non-routine transactions, such as a business acquisition or a significant restructuring of an organisation, will increase the transaction-specific risk (Elgood, 2004).

As a general rule, the higher the inherent transactional risk, the more likely tax authorities are to carry out a detailed review of the economic rationale of the transaction and its associated tax characteristics (Bakker & Kloosterhof, 2010). The operational characteristics of the taxpayer, including an established pattern of non-compliance with tax laws, are additional factors which could lead to increased scrutiny by tax authorities (Elgood, 2004).

‘Compliance risk’ refers to the risk of misapplication of the relevant tax laws, whether due to fraud or error (Elgood, 2004). The promulgation of new tax laws, together with the growing complexity of tax provisions, is a primary source of compliance risk (De Koker and Williams, 2011). Variations in the operational processes followed by the tax authorities can also give rise to an elevated risk of non-compliance (Stamm, 2004). For example, the need to complete a company’s tax returns correctly, to ensure that these are submitted on time, and to ascertain that the returns take cognisance of the recent amendments to tax laws are material sources of compliance risk (Stamm, 2004; Weinberger et al., 2012). This risk is, however, also a function of the operational and governance characteristics of an organisation, with the result that operational and compliance risk are interconnected and difficult to ‘disentangle’.

‘Operational risk’ is defined as ‘the risk of loss resulting from inadequate or failed internal processes, people, systems or external events’ (Basel II, 2006:144). Operational risk is similar to compliance risk in that it is concerned with adherence to the tax laws and decisions about the management of the final tax charge (Elgood, 2004; Bakker & Kloosterhof, 2010). Operational risk is, however, a function of the nature of the organisation, including the characteristics of its primary economic activities (part of transactional risk) and how these are managed, rather than simply a product of misapplication of tax laws. Consequently, operational risk is addressed, not simply by focusing on adherence to the letter of tax regulations, but by making use of adequate information and control systems that can provide accurate and complete information on which to base tax returns and disclosures (Stamm, 2004; Bakker & Kloosterhof, 2010). Therefore, operational risk is also affected by the extent to which an organisation makes use of a sound
system of internal controls designed to provide assurance about the accuracy, completeness and validity of individual transactions.

Effective management of transactional, compliance, and operational risk needs to be complemented by an awareness of financial accounting risk. The divergence in the treatment of transactions, events and conditions for financial reporting and tax purposes can itself pose a material source of tax risk (Elgood, 2004). Deferred tax implications (IASB, 2012) due to these differences mean that management must manage effectively not only its current tax charge, but also the future tax implications of the recovery or settlement of assets and liabilities (consider Elgood, 2004; Bakker & Kloosterhof, 2010; IASB, 2012). Going hand-in-hand with this is the possibility that organisations focus on the financial reporting implications of a transaction, to the detriment of prudential tax management (Mc Grail, 2011). Reinforcing the need for management of operational risk, management of financial accounting risk implies a holistic approach, where the accounting and tax implications of transactions are accorded equal importance in order to ensure tax compliance (compliance risk) and the provision of relevant and reliable tax disclosures in the financial statements (Elgood, 2004; Bakker & Kloosterhof, 2010).

2.2. Tax-generic risks

‘Portfolio risk’ is the aggregation of transactional, operational and compliance risk discussed above (Elgood, 2004; Stamm, 2004). This ‘risk class’ sees the organisation as a collection of different economic activities, which, individually and collectively, pose transactional, operational and compliance risks and which, in aggregate, give rise to a ‘portfolio’ of tax risk (consider Erasmus, 2008; Bakker & Kloosterhof, 2010). The portfolio risk of a company would, theoretically, be determined by computing a weighted average probability of each specific tax risk resulting in material financial loss and ought to be reviewed on a continuous basis (Stamm, 2004; Bakker & Kloosterhof, 2010).

This, in turn, forms a part of management risk. Unlike operational risk, management risk is not an assessment of tax risks arising at transactional or operational levels, but rather about a culture of comprehensive TRM (Weinberger et al., 2012). Management risk will be inversely related to the extent to which an organisation relies on the review of tax practice at senior levels and places the economic reality of transactions ahead of the need to achieve a predetermined tax outcome. In line with the recommendations of the IRC (2011), management risk would also be mitigated by developing a clear strategy for dealing with tax authorities and defining the organisation’s appetite for tax avoidance. This necessitates not only a sense of business ethics when it comes to tax, but also the use of appropriately qualified staff at senior levels to ensure effective monitoring and review of tax-related issues in the company’s control environment (consider Erle, 2006; Weinberger et al., 2012).

The on-going economic difficulties in the USA, Europe and South Africa have magnified the relevance of TRM. Crisis perpetuates the use of broader and more sophisticated regulatory measures (Maslich & Gendon, 2011). The tax environment is no exception, with governments under fiscal pressure attempting to reduce tax evasion and avoidance. Integral to this is the implementation of more sophisticated rules for the taxation of transactions, including more aggressive anti-avoidance and evasion mechanisms (De Koker & Williams, 2011). The relevance of codes of corporate governance which call for responsible, fair and honest business conduct should also not be overlooked (see Solomon, 2010; IRC, 2011). Each provides an impetus for effective TRM that is mindful of the complexity of tax law; the importance of a highly competent
tax department; and general business management practices which do not ignore the economic reality of transactions simply to minimise the tax charge (see Erle, 2006; Bakker & Kloosterhof, 2010). Needless to say, those companies with strong management risk practices would be expected to have lower operational, compliance, transactional and portfolio risk levels. Another benefit is enhanced reputation.

Reputational risk is concerned with the tax practices of an organisation posing a threat to its credibility as a legitimate institution (Elgood, 2004). For example, if aggressive tax practices become public, an organisation may be perceived as conducting its business recklessly, without regard for the importance of fair and sustainable practices that are mindful of the interests of a broad group of stakeholders (Stamm, 2004; Bakker & Kloosterhof, 2010). In extreme situations, a perceived inconsistency between an organisation’s tax policies and a generally accepted view that one ought to pay a fair share of the profits generated to the fiscus (Vivian, 2006) can pose significant threats to an organisation’s longevity. This is especially true in the context of the global financial crisis, which has seen many companies, such as Starbucks and Amazon, come under increased public scrutiny for allegations of tax practices that are inconsistent with the ideals of contributing sustainably to the relevant jurisdictions in which they operate (Weinberger et al., 2012).

3. TAX RISK-MANAGEMENT BY AUTHORITIES IN THE USA, UK AND SOUTH AFRICA

The generic and specific tax risks discussed above will be analysed in section 3, based on the legislative tax risk-management implementations enacted to address them. This will be done on a comparative basis, contrasting the USA, UK and South Africa (section 3.2). The various legislative implementations will be discussed first (section 3.1).

3.1. Legislative developments in the USA, the UK and South Africa

3.1.1. The USA

The collapse of Enron in 2001/2002, followed shortly by WorldCom, prompted significant reform of the American corporate governance landscape, most notable of which was the promulgation of SOX (Canada et al., 2008; Riotto, 2008). SOX is fundamentally about risk-management and disclosure (Taylor, 2005). It was enacted to enhance corporate governance by improving companies’ internal controls, enhancing credibility and improving corporate transparency. A company’s management of its tax risk forms part of this.

According to Title X of SOX, the corporate tax return should be signed by the Chief Executive Officer (SOX, 2002). Per Deloitte (2009), 54% of Forms 10-K and 10-Q (dealing with the disclosure of a company’s financial performance) filed with the Securities Exchange Commission (SEC) from January 2008 to December 2008 reported material tax weakness (see also SEC, 2012). The majority of the failures are attributable to a lack of appropriately qualified personnel, as well as the fact that the companies surveyed did not maintain effective controls over the determination and reporting of the provision for income taxes (Bakker & Kloosterhof, 2010). The most prevalent tax risks encountered relate to federal income tax, although other important areas include state income tax, franchise and gross receipts taxes, property tax and payroll tax (Bakker & Kloosterhof, 2010).
In the USA, the scope of income tax is extensive, because it includes ‘gross income ... from whatever source derived’ in a taxpayer’s taxable income (Bakker & Kloosterhof, 2010). This results in foreign corporations being taxed on all income that is ‘effectively connected’ with trading or business in the USA (Weinberger et al., 2012; Internal Revenue Service (IRS), 2013). An inherently complex system (IRS, 2013) gives rise to several risk areas. For example, rules regarding the source of income may become arbitrary or require the application of judgement (Weinberger et al., 2012). Secondly, foreign tax credit rules and complex tax treaties are difficult to apply in practice (Bakker & Kloosterhof, 2010). Thirdly, ‘withholding and government information reporting requirements’ with respect to certain outbound payments or the transfer of assets may be diverse and result in errors (Weinberger et al., 2012). Finally, transfer pricing rules in the USA, which require ‘arms-length’ intercompany pricing evidenced by simultaneous documentation and analysis, may be complex and lead to misapplication (Bakker & Kloosterhof, 2010). The American government has introduced several programmes to address this, the majority of which are administered directly by the IRS with an aim to ensuring that taxpayers pay their fair share (Cohn, 2012; IRS, 2012; Weinberger et al., 2012).

1) Disclosure Policy: This policy requires detailed and transparent disclosure of the company’s tax position to the IRS (Cohn, 2012). The aim is to reduce transaction risk. This is achieved through detailed and transparent disclosure of the company’s tax position, related to specific transactions, a process which is made all the more important by §6662 of the Internal Revenue Code (IRC), dealing with penalties for inaccuracy of tax returns and underpayments (Godfrey, 2012). The disclosure policy, as an incentive to encourage compliance, also provides that a position which is adequately disclosed on a tax return should generally not be taken into account in calculating penalties due to inaccurate tax estimates. Certain other tax penalties imposed by the IRS may also be waived if taxpayers can demonstrate that they have exercised due care and skill in computing their tax liability and clearly disclosed their assumptions (Bakker & Kloosterhof, 2010).

2) Reportable Transactions Policy: A list of ‘reportable transactions’ is published regularly by the IRS. These generally include transactions which the IRS views as potentially abusive or ‘tax shelter’ transactions (Palmer, 2012). Non-compliance could result in penalties of up to USD 200 000 per transaction, as well as non-compliance disclosure penalties levied by the SEC (Palmer, 2012). Accordingly, this programme plays a part in reducing an entity’s transaction and compliance risk by providing an incentive to avoid the deliberate structuring of transactions for tax purposes (Elgood, 2004). An entity’s tax department would need to be cognisant of all transactions entered into and would need to ensure that appropriate documentation is available to justify its tax position (Elgood, 2004; McGrail, 2011).

3) Period Limitations Policy: This involves limitations imposed by the American Congress on the time period during which the IRS may assess taxes and taxpayers may claim a refund or tax credit (Cohn, 2012). By providing a clear cut-off point after which the tax position must be finalised, the tax liability of the organisation may be determined with greater certainty, thereby lowering transactional and compliance tax risks (Bakker & Kloosterhof, 2010; Cohn, 2012).

4) Pre-filing agreement: This programme encourages taxpayers to request an examination of an issue before the tax return is filed and, thus, resolves potential issues as early as possible (Cohn, 2012). Allowing the taxpayer and the IRS to determine the tax consequences of a transaction before a return is filed can reduce reputation risk by pre-
empting formal disputes. Operational and compliance risk may also be lowered (Hassing, 2012).

(5) CAP: The Compliance Assurance Process allows a taxpayer to work through all of the potential issues with the IRS before filing a return (Cohn, 2012). The objective of this programme is to reduce uncertainty when applying tax laws to a transaction, while assuring the IRS of accuracy of tax returns prior to filing. The programme also eliminates problems associated with loss of data and documentation in the case of examinations conducted years after the transactions at issue and the filing of the return (Cohn 2012; IRS 2012). The CAP programme is expected to act as an effective deterrent to non-compliance with tax laws, thereby lowering transactional, compliance, operational and reputational risk (consider Weinberger et al., 2012).

(6) LIFE programme: This process uses a risk-based approach for limiting the scope of an IRS examination to the areas of the greatest risk of non-compliance (IRS, 2012). LIFE is not appropriate for fraudulent, unwilling or uncooperative taxpayers (Bakker & Kloosterhof, 2010; Cohn, 2012). For the majority of taxpayers, however, it encourages an entity to manage its disparate tax risks more effectively (Stamm, 2004), and thus encourages companies to lower their tax management and portfolio risks (Elgood, 2004).

(7) IRS Audit techniques guide: These guides assist companies in identifying, co-coordinating and resolving complex and significant industry-wide tax issues by providing specific guidance to ensure uniform application of tax rules (Bakker & Kloosterhof, 2010). This also assists corporates by reducing their operational and tax-management risks by allowing the development of policies and procedures (based on guidance provided by the tax authorities) for determining the tax consequences of more complex transactions.

3.1.2. The UK

In the UK, the Greenbury Report, Hempel Report and, most recently, the Combined Code, stress the importance of a flexible system of corporate governance able to respond to emerging risks and ensure corporate transparency and accountability (Solomon & Solomon, 2004). In particular, the Combined Code, coupled with the recommendations of the Turnbull Committee, requires companies to review and express an opinion on the functioning of the system of internal controls and risk-management (Solomon & Solomon, 2004; Page & Spira, 2012). The ultimate aim is to assist companies in establishing a formal risk-based approach to corporate governance. A key feature of the Turnbull report is that it emphasises the importance of ongoing and systematic risk-assessment, as well as the importance of instituting risk-management and internal control (Turnbull report, 1999; Page and Spira, 2012). Although they do not deal specifically with the issue of TRM, many of these principles apply in a tax setting.

In the UK, companies follow a self-assessment process for their tax returns. This means that a company must notify Her Majesty’s Revenue & Customs (HMRC) of its tax charge. Each company is responsible for determining its own tax liability and filing a tax return which must be supported by appropriate documentation. Once this has been completed, the HMRC may file queries on the return within 12 months of its submission (Bakker & Kloosterhof, 2010). Similar to the USA, the UK authorities have also responded to an increase in the risk of non-compliance with tax laws with a number of schemes:

(8) TCRM Programme & rating process: The tax-compliance risk-management programme and rating process requires companies to adhere to a standard template covering six factors:
complexity, boundary, change, delivery, governance and tax strategy (HMRC, 2012). Based on these factors, companies are rated by their tax officers as being either low- or high-risk taxpayers (HMRC, 2012). This will ensure that companies with a well-developed tax philosophy and control framework (Stamm, 2004) and strong management over their tax management and portfolio risks (Erle, 2006) will be able to comply more effectively with TCRM.

In essence, TCRM is concerned with a company’s ‘inherent tax risks’, in particular, the risk of non-compliance with tax laws as a result of the size and scope of the business and the nature of transactions which it enters into (Bakker & Kloosterhof, 2010; HMRC, 2012). The TCRM Programme addresses this by encouraging companies to implement an effective tax risk-management strategy backed by suitable controls and processes. Integral to this is ensuring that the board of directors and company tax officers are carrying out suitable reviews of tax-risk areas and are held accountable for departures from the respective tax laws (Bakker & Kloosterhof, 2010). As such, the TCRM Programme directly or indirectly assists in lowering the level of transactional, compliance, operational and management risk in organisations (Elgood, 2004). In turn, companies which implement effective systems for managing their tax risks are likely to enjoy lower costs of compliance, fewer disputes with tax authorities, and a lower level of reputational risk.

(9) Litigation and settlement strategy: Similar to the initiatives of the IRS discussed above, the predominant aim is to provide greater clarity and certainty in the resolution of disputes between the HMRC and the taxpayer (Bakker & Kloosterhof, 2010). This strategy aims to resolve each dispute on its own merits. No compromise agreement or settlement will be considered (Bakker & Kloosterhof, 2010), but the HMRC will pursue only meritorious cases (Bakker & Kloosterhof, 2010). The effect of this is that organisations will need to devote greater time and resources to effective tax risk-planning (Bakker & Kloosterhof, 2010). In this way, the policy aims to improve a company's tax operational, compliance and management risks.

(10) Penalty regime programme: This programme is aligned with the TCRM Programme. It is aimed at non-compliant taxpayers and heavily penalises systematic understatement of liabilities, tax evasion and deliberate concealment of offences (Bakker & Kloosterhof, 2010). It is expected that most companies will be inclined to improve their processes, controls and systems’ rather than simply pay the penalty (Groom, 2010). This will, in turn, reinforce the idea that companies manage their specific operational risk as well as their generic management, portfolio and reputational risks (Elgood, 2004; Erle, 2006).

(11) SAO Legislation: Senior Accounting Officers (SAOs) of qualifying companies, being those with a turnover in excess of GBP 200 million or a balance sheet of more than GBP 2 billion, are required to sign an annual declaration that ‘appropriate accounting arrangements’ have been used to calculate the company’s tax liabilities (Williams, 2009). If the arrangements fall below this standard, the SAOs will be held personally responsible and subject to a financial penalty of GBP 5000 per instance, as well as a possibility of further penalties for related compliance failures (Callahan, Copsey & Harley, 2012). The legislation reinforces the need for effective TRM by holding SAOs accountable for tax compliance and management. It also encourages the use of an effective system of internal control over tax risks (Williams, 2009), indirectly improving a company’s awareness of its tax risks and need for effective TRM practices (Bakker & Kloosterhof, 2010; Callahan et al., 2012). In the long run, the legislation would, therefore, be expected to mitigate
operational and compliance risk (Bakker & Kloosterhof, 2010) and lower tax management, portfolio and reputation risk (Erle, 2006).

3.1.3. South Africa

Following the release of King I in 1994, South Africa’s second King Report on corporate governance placed emphasis not just at the level of the board of directors, but on a more holistic approach to corporate reporting. This recognised the relevance of a wider group of stakeholders and the importance of non-financial disclosures, including effective risk-management policies (IOD, 2002; Solomon, 2010). King II dealt specifically with risk-management (IOD, 2002; Berwick, 2007), including the need for the board of directors to be responsible for the process of designing, implementing and monitoring the process of risk-management. All policies should be clearly communicated to stakeholders, and the risk strategy should be incorporated into an organisation’s operating ethos (IOD, 2002). The board is also responsible for maintaining and implementing sound systems of risk-management, as well as for ensuring the effective utilisation of risk-management frameworks in order to maintain a sound system of internal controls (IOD, 2002). This should culminate in formal risk documentation and management, including a risk-management policy. The board ought to be responsible for determining the risk appetite of the company and for managing threats to the sustainability of the organisation. Consequently, the company’s exposure to risks from non-compliance with laws and regulations, including tax laws, should be examined, assessed and managed at the highest level (IOD, 2002).

These principles were reiterated by King III (IOD, 2009; Smith & Jenkins, 2009), which also calls for the creation of a risk-management plan, including risk committees, to assist the board with its risk-management functions (IOD, 2009; Smith & Jenkins, 2009). In addition, full disclosure in the integrated report of management’s view on its significant risks is encouraged (Smith & Jenkins, 2009; IRC, 2011). As with the situation in the USA and UK, these risk-management principles are equally relevant when it comes to South African tax, where the South African Revenue Service (SARS), like its American and British counterparts, relies on several schemes to promote effective TRM:

(12) King Codes on Corporate Governance: Increased emphasis on effective corporate governance has led to more interaction between SARS and large corporations through the operation of the Large Business Centre (LBC). The LBC was created to facilitate the collection of taxes from, and audits of, large businesses in South Africa (Smith & Jenkins, 2009); the implementation of tax steering committees (IOD, 2009; Smith & Jenkins, 2009); and regular internal tax reviews where errors are identified and corrected (Bakker & Kloosterhof, 2010). In addition, the move towards a more integrated system of governance and reporting (IOD, 2009; IRC, 2011) has led to more effective tax strategy development. This entails mapping any tax issues and determining, through a formal review process, how these should be reported to SARS and dealt with by companies (Smith & Jenkins, 2009; Bakker & Kloosterhof, 2010). In this way, codes of corporate governance have indirectly encouraged the management of a wide range of tax risks and led to a reduction in operational, compliance, portfolio, management and reputational risk.

(13) E-filing process: The e-filing process recently implemented by SARS has resulted in increased risk-exposure. On-line filing of tax returns allows for more rapid review of submissions, including the tracking of outstanding returns and trends in taxpayers’ incomes and deductions. In this way, it allows SARS more readily to hold taxpayers...
accountable for non-compliance with the country’s tax laws (Bakker & Kloosterhof, 2010). (E-filing also plays an important part in promoting the moral duty of taxpayers to pay their fair share, given the reduction in the administrative costs associated with submitting tax returns). This monitoring by SARS, coupled with fines and penalties, provides a significant incentive for companies to manage their operational and compliance risks (Bakker & Kloosterhof, 2010).

(14) Reportable transaction provisions: These are additional provisions introduced as an anti-avoidance measure, and require companies to report structured finance and cross-border transactions (Bakker & Kloosterhof, 2010). This has forced the South African corporates to actively monitor and consider their transaction and compliance-specific tax risks (section 2.1), while ensuring that penalties are reduced through a holistic and integrated tax compliance framework and tax philosophy framework (Erle, 2006). The result is reduced operational and management risk.

(15) Tax Administration Act No. 28 of 2011: The TAA was promulgated on 4 July 2012 and took effect on 1 October 2012 (Deoitte, 2013). This Act seeks to merge the body of law covering all taxing statutes (except customs duty) (Deoitte, 2013). It has granted SARS more powers to audit and examine taxpayers (Deoitte, 2013). This Act also introduces a voluntary disclosure programme in terms of which SARS will not pursue criminal prosecution. The decision to prosecute a taxpayer will be based on the prevalence of prior instances of non-compliance and the nature of the respective non-disclosure (Deoitte, 2013). The introduction of this system aims to improve the governance and tax control structures of a business by promoting the incorporation of TRM in its general control structures (Walker & Meiring, 2010). Consequently, the introduction of the TAA encourages companies to manage their operational, compliance, management and reputational tax risks better.

3.2. Comparative analysis

The various schemes in operation in the USA, UK and South Africa, and how these promote the mitigation of specific and generic tax risks, are summarised below. (Each policy, discussed above, is labelled from P1 to P15 to enable ease of comparison and is in line with the numbering in section 3.1).

The USA has the widest range of tax policies and procedures explicitly covering all generic and specific risks with the exception of financial accounting risk. This is in line with both the size of the American economy and relative complexity of its tax laws given its federal system of government (Kelly, 2013). As highlighted in TABLES 1 and 4, the focus is largely on reducing transaction and compliance risk, with the result that the American approach to TRM-related issues tends to concentrate on specific, rather than generic, risk areas. For example, as discussed in section 3.1.1, the disclosure and period limitations policy seeks to encourage US taxpayers to focus on reducing the tax risks associated with transaction structuring.
### TABLE 1: TRM programmes in the USA

<table>
<thead>
<tr>
<th>Risks</th>
<th>Transactions</th>
<th>Operational</th>
<th>Compliance</th>
<th>Financial accounting</th>
<th>Portfolio</th>
<th>Management</th>
<th>Reputational</th>
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<td>Disclosure Policies (P1)</td>
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**Source:** Authors’ deductions

### TABLE 2: TRM programmes in the UK

<table>
<thead>
<tr>
<th>Risks</th>
<th>Transactions</th>
<th>Operational</th>
<th>Compliance</th>
<th>Financial accounting</th>
<th>Portfolio</th>
<th>Management</th>
<th>Reputational</th>
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<tr>
<td>Litigation &amp; Settlement Strategy (P9)</td>
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<td>Penalty regime programme (P10)</td>
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<td>SAO Legislation (P11)</td>
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</tr>
</tbody>
</table>

**Source:** Authors’ deductions
TABLE 3: TRM programmes in South Africa

<table>
<thead>
<tr>
<th>Policies</th>
<th>Transactional</th>
<th>Operational</th>
<th>Compliance</th>
<th>Financial accounting</th>
<th>Portfolio</th>
<th>Management</th>
<th>Reputational</th>
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</thead>
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<td>King codes on corporate governance (P12)</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>E-filing process (P13)</td>
<td>✓</td>
<td>✓</td>
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<td>Reportable transactions provisions (P14)</td>
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<td></td>
</tr>
<tr>
<td>TAA (P15)</td>
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</tbody>
</table>

Source: Authors’ deductions

TABLE 4: Summary of policy implementations

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<tr>
<th>USA</th>
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<th>P6</th>
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<tr>
<td>UK</td>
<td>P8</td>
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<td>P8</td>
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<td>P12</td>
<td>P12</td>
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</tbody>
</table>

Source: Authors’ deductions

The UK and South Africa also deal with transactional risk (TABLES 2 and 3), but the focus in these jurisdictions is more on compliance and operational risk. The three jurisdictions recognise the importance of TRM as a means of increasing revenue collection (see Bakker & Kloosterhof, 2010), although South Africa (TABLES 3 and 4) and the UK (TABLES 2 and 4) appear to have adopted the approach of relying on fewer policies, with the intention that individual policies cover a broader range of risks. In these countries, almost all of the policies discussed in section 3 cover operational and management risk. This should be juxtaposed with the USA, where these risks are addressed directly by only 38% of the country’s policies (section 3.1.1).
The TCRM programme in the UK and the LBC (in conjunction with King III) in South Africa, for instance, are designed specifically to reinforce the importance of broad TRM policies and procedures designed to reduce portfolio, management and reputational risks. This finding is in line with the conceptual model at the heart of South African and British codes of corporate governance (IOD, 2009; Solomon, 2010). TRM in these countries is characterised by less dependence on prescriptive policies in favour of incorporating a TRM ethos as part of an enterprise’s risk-management culture (Solomon, 2010).

For South Africa in particular, the management of portfolio and management risk is addressed comprehensively as part of a broad corporate governance strategy which stresses the importance of responsible, sustainable and ethical business practice (including TRM) (Erle, 2006). This includes adhering to a TRM philosophy of defining a corporate governance framework and establishing an unambiguous risk-appetite which incorporates tax-related issues (Erle, 2006). This is evidenced by the recent introduction of the TAA (relying on a risk and reward framework), an emphasis on transparency and certainty when determining a tax position, and a clear focus on the moral imperative of paying one’s fair share of taxes (Honeyball, 2013).

4. CONCLUSION

The corporate governance landscape has seen significant change over the last 15 years (Weinberger et al., 2012), providing an impetus for the rapid transformation of systems for managing and controlling risk. In particular, effective risk-management and control has adopted a broader perspective, especially when it comes to TRM. Taxation is no longer a resultant but rather a material source of risk for the sustainability of organisations, with the result that compliance with the relevant tax laws and regulations needs to be actively monitored and controlled (see Solomon & Solomon, 2004; Erle, 2006).

In this context, section 2 focused on the classification of tax risk as either ‘specific’ or ‘generic’ and discussed the nature of each of these broad tax risk ‘categories’. This provided a frame of reference for exploring the introduction of recent policies and procedures used by taxation authorities in the USA, the UK and South Africa for the purpose of improving tax compliance in general. In each of these jurisdictions, there is a clear awareness of the need for a system of checks and balances to mitigate the risk of avoidance or evasion of taxation by corporates. This is especially true given the ongoing financial crisis placing pressure on tax bases. A different approach for encouraging prudential TRM in the USA, on the one hand, and the UK and South Africa, on the other, is, however, followed. In America, there appears to be more emphasis on the management of transaction risks using very detailed prescriptions to manage specific tax risk areas. The HMRC and SARS are also concerned with the management of transaction-level risks, but place more emphasis on dealing with management and operational risks. Going hand-in-hand with a conceptual model of codes of governance, TRM in South Africa and the UK also tends to focus more on the need for a holistic model of risk-management and control that appears to deal more comprehensively with generic tax risks than in the USA.

The researchers use ‘appears’, as the inherent limitations of this research make it difficult to reach definitive conclusions. The descriptive nature of this paper, coupled with its focus on only three tax jurisdictions, means that the exact relationship between conceptual or rules-based models of corporate governance and TRM policies needs to be examined in more detail. Related to this, exactly how these TRM policies engender compliance with the respective tax laws needs to be investigated. For example, what is it about an electronic filing system or the use of tax-
based audit that causes taxpayers to adhere to tax prescriptions? How exactly does the TAA (in South Africa) and disclosure policies in the USA and UK achieve a sense of corporate accountability when it comes to tax risk-management? These issues require a more rigorous approach than that followed in this research. Empirical testing on the costs and benefits of each of the policies discussed in section 3, detailed interviews to shed light on their practical operation, or even the use of controlled experiments or ethnographies could be very useful for demonstrating how tax authorities exercise power over taxpayers and how TRM policies may evolve in response to recent regulatory and governance developments. Ultimately, with only a limited number of studies concerning themselves with TRM as part of the broader corporate governance machinery, this particular area of corporate governance is little researched, offering numerous opportunities for future academic efforts.

LIST OF REFERENCES


Solomon, J. (2010). Corporate Governance and Accountability, 3rd edition. West Sussex: John Wiley and Sons Ltd.


