PwC TLS Avvocati e Commercialisti

Tax Control Framework and cooperative compliance

Effective tax risk management and control mechanisms

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Tax risk management: an essential necessity

Manage risk, to seize opportunities

> **The Chinese use two brush strokes to write the word 'crisis'. One brush stroke stands for danger; the other for opportunity. In a crisis, be aware of the danger–but recognize the opportunity".**
> *John Fitzgerald Kennedy*

- **Tax risk management** plays an increasingly important role in corporate governance, given the financial and reputational consequences associated with tax infringements. The **Tax Control Framework** (TCF) is the internal control system of the tax risk that allows for its accurate monitoring, control and evaluation.

- The concept of taxation and the approach to managing the risks involved in the correct assessment of taxes have become part of the catalogue of **sustainability** indicators, now summarised in the acronym **ESG**. The presence of a tax risk management system thus becomes a key element in corporate governance.

- **Transparency** in taxation has also become an integral part of the content of ESG reporting and, in particular, of **non-financial reporting** as we know it today (Directive 2014/95/EU and GRI 207), as well as in the forthcoming developments to extend its scope (proposal for an EU Directive on sustainability reporting).

- The tax authority's surveillance activities on larger taxpayers will be increasingly focused on those entities presenting a higher tax risk, including those **failing to exhibit cooperative and transparent behaviour** (Circular letter of tax authorities no. 4/E of 7/5/2021).

- Following the update of Legislative Decree no. 231/2001, significant tax violations have been included in the catalogue of presumed offences for which entities are liable for administrative offences dependent on a crime offences. Companies are therefore called upon to **update their organisational models** to avoid incurring **large fines and disqualification penalties**. The TCF also mitigates the risk of tax fraud as well as of criminal tax violations.

- The TCF entitles the company to enter the **cooperative compliance** regime, which allows it to avoid the need **for surveillance activities at a later date**, in order to initiate a **dialogue** with the tax authority on uncertain and controversial tax positions, with the aim of obtaining certainty prior to the submission of the declaration (Legislative Decree no. 128/2015).

- The management of tax risk is a central issue for financial reporting purposes, as IAS adopters are required to intercept '**uncertain tax positions**' for the disclosure of tax liabilities (IFRIC 23). For the purposes of customs legislation, in order to qualify as an authorised economic operator (AEO), it is required to demonstrate the existence of appropriate controls over import/export processes.The use of procedures for tax management, which is a basic feature of TCF, makes it possible to comply with the above-mentioned reporting and customs requirements.

Risks

- Pecuniary and reputational damages.
- 231 liability of entities.
- Uncertainty of tax choices.
- Tax Transparency.

Opportunities

- Sustainability ratings.
- Controlling tax risks.
- Mitigation of liabilities and reduction of penalties.
- Advance certainty on tax positions.

The Tax Control Framework

The Tax Control Framework (TCF) is a set of rules, procedures, organisational structures and controls, aimed at allowing the detection, measurement, management and control of tax risk, understood as the risk of incurring in violation of tax laws or contrast with the principles and objectives of the legal system (abuse of law).

OECD: building blocks

- Tax Strategy Established
- Applied Comprehensively
- Governance Documented
- Responsibility Assigned
- Testing Performed
- Assurance Provided

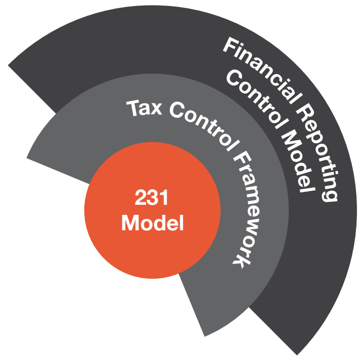
The TCF model that we provide our clients is compliant with the **OECD and Italian Tax Authorities guidelines** and meets the **requirements of GRI 207**, thus enabling the path to certified sustainability reporting.

Essential requirements

1. **Control Environment:** adoption of a Fiscal Strategy, approved by the Board, to define the principles and limits underlying the management of fiscal risk;
2. **Risk Assessment:** identification of potential tax risks as well as tax fraud affecting the company and establishment of appropriate measures to detect their presence and mitigate their effects;
3. **Governance:** identification of roles and responsibilities of parties involved in the management of the tax variable, definition of information flows between these parties and of processes for the effective and, where possible, preventive control of tax risk;
4. **Monitoring:** verification activities carried out on an ongoing basis to assess the adequacy and effectiveness of the implemented tax control framework;
5. **Reporting:** periodic reports to the Board.

Integration into the internal control system (*Onion Skin Model*)

For the purposes of implementing the Tax Control Framework, it is essential to adopt of **an integrated approach**, aimed at maximising synergies between the company's **internal risk control systems** (e.g., the control system on financial reporting under Law no. 262/2005; SOX controls, organisational models under Legislative Decree no. 231/2001; Enterprise Risk Management systems, anti fraud programs), ensuring interactions between them in order to better protect the company (onion skin model) and avoid inefficiencies in control activities.



Our assistance

Maturity assessment
Analisi as is

Preliminary analysis to understand the extent of the fiscal risk in the company.

Tax Strategy and governance rules

Definition and formalisation of the fiscal strategy and governance rules.

Tax Risk assessment and Gap Analysis

- Identification of the main tax risks and related safeguards.
- Gap analysis and remediation plan.

Remediation implementation

- Formalisation of processes and procedures.
- Digitalisation of tax processes.
- Design and implementation of control and detection solutions.
- Miscellaneous.

Constant monitoring

- Testing of adequacy and effectiveness of controls.
- Periodic update.

Cooperative compliance regime

The cooperative compliance regime makes it possible to initiate, with regard to uncertain and controversial tax positions, a **preventive dialogue** with the tax authorities, in order to reach a common assessment of the facts underlying the business choices that involve tax uncertainty, **anticipating and exhausting the controls** of the tax authorities. The presence of a system of detection, measurement, management and control of tax risk “constitutes the prerequisite for activating more evolved forms of operation of the Revenue Agency aimed at assessing the tax position of the taxpayer also through the verification of the system of management and control of tax risks” (linked to Legislative Decree no. 128/2015).

Co-operative compliance

1 **Tax Control Framework**

Detection of uncertain or controversial fiscal positions

2 **Preventive dialogue**

Agreement with the ITA

«Agree to disagree»

3 **Tax Compliance**

Payment of taxes and tax returns

Risk mitigation

- Exclusion of further controls
- Advance certainty
- Right of dissent
- Single point of contact
- Reduced penalties

Who is eligible to join?

1. Entities with revenues or turnover of not less than **€ 1 billion** for the years 2022, 2023, 2024 (Ministerial Decree 31.1.2022);
2. Entities who intend to implement the response of the Italian Tax Authorities (ITA), provided following **a tax ruling on new investments** regardless of the revenues or turnover (art. 2 of Legislative Decree no. 147/2015);
3. Possible extension to all entities applying the VAT Group;
4. Entities carrying out TCF **management activities** over the entities listed under the items 1 and 2 above;
5. Non-resident entities that intend to adhere to the “**web tax procedure**” provided for by Decree Law no. 50/2017.

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The tax ruling on new investments is a request that may be submitted to the Tax Authority by Italian or foreign investors who intend to undertake major investments in Italy, with a value of not less than fifteen million euros, with significant and lasting repercussions on employment, in order to identify with certainty the overall tax treatment.

Our assistance

Pre-filing and Application for Admission - TCF Design

- Pre-filing with ITA.
- Application for admission to the scheme and formalization of the documentation.

Post-filing
TCF implementation

- Post-filing with ITA.
- Support for the Tax Risk Officer.
- Training of the Tax Risk Officer.

Post-admission
TCF Maintenance

- Discussions with Italian Tax Authority.
- Annual Report.

Tax violations and liability of entities as per Legislative Decree no. 231/2001

Updating of organisational models and TCF

A significant part of tax violations, ascribable to **tax fraud**, have entered the catalog of predicate offences for the **liability of entities** for administrative offences arising from crime, governed by Legislative Decree no. 231/2001 (Ref. Law Decree no. 124/2019, converted into Law no. 157/2019 and Legislative Decree no. 75/2020 - implementing Directive (EU) 2017/1371, known as the “PIF Directive”).

The penalties applicable to entities, in relation to the commission of these crimes, may be financial as well as prohibitory.

The **financial penalties** range from a minimum of € 77.400 to a maximum of € 774.500.

Prohibitory penalties are of considerable impact, such as a ban on performing activity, the prohibition to contract with the public administration or to advertise goods or services. There are also provisions for **preventive seizure** and **confiscation** of the price or profit of the offence.

It is therefore necessary to update the Organisation, Management and Control Model (MOGC) to include the tax risks associated with the types of tax offences that have entered the so-called “231 catalog”.

The MOGC will have to map out procedures aimed at defining roles, responsibilities, principles of conduct, operating procedures, as well as the behavioural criteria that individuals must maintain in order to avoid tax fraud offences being committed.

TCF tax fraud

This is the occasion to start implementing the TCF, an internal control system specifically dedicated to tax risk, starting with the listing of cases that fall within the scope of **tax fraud** offences.

Integrated TCF

For companies that **already have a TCF in place**, to monitor areas of tax risk other than fraud, it is appropriate to carry out the integration of the “risk map”, as the Italian Tax Authority requires:

- The mapping of anti-fraud safeguards relevant to taxation.
- The reporting, within the scope of advance discussions, of all cases connected with tax fraud risks, regardless of the agreed materiality thresholds.

Cooperative compliance

In the case of adherence to the cooperative compliance regime, according to the Tax Police, *“the **positive outcome** expressed by the Revenue Agency for the purposes of **admission** to cooperative compliance may constitute a useful **factor in assessing the efficacy of the model** provided for by Legislative Decree no. 231/2001, which is to be referred to the autonomous assessments of the competent Judicial Authority”*. (Circular letter of Tax Police 1/09/2020).

Digital services developed by PwC for tax risk control

The intrinsic complexity arising from the regulatory framework and the need to ensure the oversight of current operations can greatly benefit from the identification of **digitalization initiatives** aimed at supporting the effectiveness and efficiency of the Tax Department.

PwC TLS has specific digital expertise to support clients in identifying and implementing the most suitable technologies for the Tax Department.

In particular, PwC TLS operates through the implementation of a **Pre-Package** based on leading third party / patented technologies, the implementation of patented technological solutions or the provision of **advanced digital services** based on the most advanced technological solutions (e.g., Data Analytics, Robotic Process Automation, Artificial Intelligence) for the analysis, certification and representation of the data managed within the fiscal processes.

Some Pre-Packages developed by PwC TLS

On the basis of the know-how gained in the field of tax consultancy, PwC TLS has developed a set of standard application packages on the main market-leading third-party platforms.

Risk & Control Matrix

The **Risk & Control Matrix** module supports users with the assessment of compliance risks through a process based on a logical workflow that begins with the mapping and preparation of the customer's processes and activities, and continues with the assessment of risks and associated controls and the formalization of any remediation activities.

Interpretative Risk

The **Interpretative Risk** module supports users in evaluating the interpretative risks in the operations that originate from updates/ new regulations coming from the different relevant sources of law, requests for advice formulated by the business departments to the tax department (ordinary and extraordinary) and the management of non-routine operations in order to **enable the constant assessment of risks** and provide users with a constantly updated overview of the risk assessment.

Third Party Analyzer

The **Third Party Analyzer** module supports the users in the screening of the Client's counterparts to intercept any related risks. The tool accesses to various information sources, reconstructing the corporate structure of the targets, the governance, the presence in the main sanctions / PEP lists, judicial status and reputation profile through the search for adverse news.

Corporate Income Tax

The **Corporate Income Tax** module supports the compilation of the IRES form, the IRAP form and the CNM form, determining, among other things: the adjustments to be made to the pre-tax income; the taxable basis; the tax provision (IRES and IRAP); the tax liabilities to be paid through the F24 form.

Transfer Pricing

The **Transfer Pricing** module facilitates a **centralized management of transfer pricing policies** applied at Group level with reference to the analysis and monitoring of the margins of intercompany operations (e.g. sale/ purchase of products) both for the budget as well as for the actual values.

Advanced digital services based on the automation of tax processes

PwC TLS provides advanced digital services, based on the most advanced technological solutions, for the analysis and representation of data managed by tax processes and for the simplification of the Tax Department's operational activities.

Data Analytics

- **Anti fraud analytics** allowing to intercept also in real time transactions in potential risky situation and *pattern* of tax fraud.
- Data Processing for the **management and analysis of databases**, also of a large size, through the use of repeatable workflows that allow to review, modify and enrich data.
- Visual Analytics that allow an intuitive navigation of data through the use of various **graphical representations**.

Robotic Process Automation

Technologies that allow users to **replicate standardized activities** performed manually on the system, mimicking their behavior and interacting with applications in the same way a user would.

Artificial Intelligence

Advanced technological solutions that **simulate human-like cognitive functions** such as learning and problem solving.

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