How businesses are responding to the wider customer tax reporting net (PART 1)

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Organizations need to transform their people, processes and technology to meet fast-changing obligations and mitigate risk

In brief

- Organizations are under increased pressure to share customers' information with tax authorities to close the tax gap and make tax collection more effective.
- While financial services companies struggle to evolve their existing processes fast enough, other organizations are falling into the CTR net for the first time.
- Organizations that fall under the tightening reporting regulations must take steps so that they have a robust and future-proofed end-to-end process in place.

The customer tax reporting (CTR) net – which obliges organizations that make customer payments to collect and share customer information with tax authorities and often withhold tax – is spreading wider, and becoming more complex. This net is also starting to encompass many non-financial sector companies for the first time, including those from the digital economy. This proliferation of CTR requirements is unlikely to slow any time soon, so it is important that organizations understand why this is happening and the steps they should take to thrive in this dynamic environment.

There are two fundamental reasons for CTR growth. The first is demand side; CTR is increasingly being used by tax authorities to help bridge the tax gap – to raise taxes without raising the tax rate. Just like the aftermath of the global financial crisis (GFC), governments burdened with COVID-19 related debt have an even greater incentive to plug gaps in their tax-collecting capabilities.

Many of the regimes that compel financial institutions to share their customers' information with tax authorities at home and overseas were established post-GFC. These include the US's Foreign Account Tax Compliance Act (FATCA), the OECD-approved Common Reporting Standard (CRS) and the digital information sharing system known as Automatic Exchange of Information (AEOI).

The second reason for the growth of CTR can be found supply side; technological advances make big data gathering, analysis and transfer easier and cheaper. The art of the possible has changed dramatically, and tax authorities are starting to use the new digital tools at their disposal.

Tax authorities in more than 100 jurisdictions are now using CTR to drive the transparency agenda. Increasingly the net is extending beyond financial services – for example the UK's Non-Resident Landlord Scheme and the EU's DAC7 tax transparency rules for digital platforms. Likewise, CTR isn't just expanding into existing data pools or platforms, it is evolving to capture new entrant asset classes for example with proposals to extend CRS to cover crypto-currencies.

What does the spreading net mean for businesses?

The challenge for businesses is transforming their tax operating model to cope with the increasing reporting demands placed upon them – not only those financial institutions who are already chasing their tails to adapt their legacy processes and technologies to the ever-intensifying regimes, but also those organizations whose innovative, disruptive business models are driving them into the CTR net for the first time.

In this dynamic environment to stand still is to fall behind. It is essential that operating models evolve to keep pace with these changes because the cost of non-compliance is many fold. It involves tax risk, reputational risk, client risk and brand risk, to name but a few.

A case in point is the ongoing program of peer reviews currently being conducted in each geography by the OECD to ensure CRS compliance. Anish Benara, EY Asia-Pacific Financial Services Partner at Ernst & Young Tax Services Limited, explains that this review alone will lead to a dramatic intensification in CTR activity.

"These reviews include establishing whether jurisdictions are conducting audits of financial institutions, or if they have compliance monitoring programs in operation," he explains. Penalties for non-compliance include fines and even jail terms for individuals found to be complicit in tax evasion. There is also a very real reputational risk for jurisdictions and organizations seen as being soft on tax evasion.

However, compliance needs to be finely balanced so that it does not negatively impact customer experience, says Benara, as this could also cause reputational damage, with customers looking elsewhere if data collection and form filling becomes too onerous. In a nutshell, customers want an easy onboarding experience . A customer onboarding experience that fails to deliver simplicity – even if a tax authority wants detail – will endanger customer experience from the outset.

How are non-financial organizations being impacted?

While most financial institutions are aware of their CTR obligations, other companies outside of financial services may find themselves in the CTR net without even realizing it. Such organizations often have a group structure with multiple entities, and one or more of those entities often end up fitting the broad definition of a financial institution, meaning it is subject to CTR regulation. Organizations with a group structure with multiple entities should not brush aside the possibility of having such financial institutions in their group, however small that entity may be.

Digital disruptor companies in sectors as diverse as ride-hailing services, video-sharing platforms and homestay brokers are already covered by FATCA if there is a US source income attached to a user transaction. However, James Guthrie, EY EMEIA CTORS Leader, says it is easy to imagine governments going one step further and creating CRS-style regulations to specifically target non-financial sector companies, if a significant uplift in tax compliance can be achieved.

"In practical terms, this could mean a homestay broker sharing its transaction data to ensure revenue from holiday homes is declared, or analyzing data from a ride-hailing service to ensure drivers are paying tax on all of their earnings," he explains.

Legacy systems prove cumbersome to evolve

While digital services companies are typically unencumbered by legacy IT systems, most financial services companies are not so lucky. Generally speaking, financial institutions' systems were built at a time when granular customer tax reporting simply wasn't on the table. For these organizations the cost of in-house proprietary solutions has become increasingly uneconomical.

One approach used by financial institutions to overcome the limitations of their legacy systems is to pull together customer data and collate it in spreadsheets and databases. However, the increasing volume of data required by FATCA and CRS can make this process expensive, time-consuming and error-prone.

In contrast, market-leading CTR solutions address customer reporting as an end-to-end process, and tackle it using automated solutions reliant on technology. Building an automated end-to-end CTR governance model in-house is far from easy, however, with major challenges on three levels — people, processes and technology. ■

(CONTINUED IN NEXT EDITION)

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