GLOBAL TAX REPORTING: REGULATORY CHALLENGES LOOM

Smart choices and targeted investments today may help contain the approaching resource crunch and the long term costs of compliance

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FATCA has placed tax reporting front and center with management committees of financial institutions, but it represents just the tip of a potentially larger iceberg.

Legislation and regulatory mandates requiring financial institutions to support cross-border tax information exchanges are on the rise, making 2017 a watershed year. Solutions and staffing that institutions implemented to comply exclusively with FATCA may not be sufficient to handle the volume of tax reporting that may be required going forward.

As a consequence, financial institutions will have to make tough decisions in the near future about how to expand their tax operations capabilities to meet increasing regulatory demands.

Reviewing FATCA’s path

Since its enactment in 2010, FATCA—the Foreign Account Tax Compliance Act—has been a prime catalyst in raising awareness of cross-border tax information reporting. But it is not the only set of requirements international organizations will be required to address.

The global community has begun creating additional tax information-sharing standards and requirements. Foremost among these is the Organization for Economic Cooperation and Development’s (OECD) new protocol for Automatic Exchange of Information (AEOI). Ninety-two jurisdictions have committed themselves to adoption of the new standard, fifty-nine of which have committed to undertake first exchanges by 2017 using the Common Reporting Standard (CRS).

AEOI will result in a monumental increase in the volume of reporting over FATCA. In a recent case study conducted by EY, the 2017 reporting volume of a non-US retail bank with over 25 million customers was estimated. The reportable account base showed an exponential increase from an estimated 2,000 accounts requiring reporting under FATCA to over 190,000 accounts requiring reports to support the requirements of CRS early adopters in the same year.
In response to the growing momentum around CRS, leading institutions are starting to consider how to analyze and monitor local tax law, compile data from myriad sources, produce and validate tax information reports, and transmit those reports to the proper tax authorities.

As early adopters come online, organizations will have to comply with dozens of local variations to reporting requirements and nuanced transmission processes mandated by each authority. In some countries, institutions may not have an established team or existing tax capabilities, while in others staff and systems may be stretched to their breaking point by the increase in the difficulty of managing and monitoring compliance.

Many executives remain comfortable with their ability to comply with the first year of FATCA reporting, but have also voiced concerns about long-term resource demands and ballooning reporting volumes.

In a recent survey of tax professionals conducted by EY, 80% of respondents were confident that they would be able to meet near-term reporting requirements for FATCA. However, 27% said that the availability of skilled resources posed a significant challenge to meeting the future demands of reporting. Further, 40% cited monitoring and adapting to the changing nature of reporting requirements as their primary reporting compliance challenge.

Reevaluating reporting options and investments

The challenges of training and retaining staff to execute reporting and track local guidance; establishing necessary data sourcing and extraction routines; designing and implementing technology; and tying it all together effectively could be overwhelming for many firms. Moreover, this additional burden yields almost no benefit to a bank’s bottom line.

But rather than viewing tax reporting as an insurmountable hurdle, leading institutions are beginning to consider how to achieve compliance in a cost effective way and in a way that reduces operational risk.

There is no one-size-fits-all approach that will work for every institution, but senior leadership has various alternatives to consider:

1. Establishing new capabilities.
2. Expanding functions that exist today.
3. Identifying third party solutions.
4. A hybrid approach on a jurisdiction-by-jurisdiction basis.

The key is identifying opportunities to leverage and expand the existing infrastructure, while defining areas that might warrant assistance from third-parties.

Deciding how to respond

There are four key elements organizations need to consider when evaluating the scope of the coming tax reporting challenge and determining how they should respond:

- **Local tax expertise.** Reporting will require a level of local tax technical knowledge in both the mechanics of preparing and filing reports and interpretation and monitoring of local tax guidance.

Each jurisdiction is likely to have a unique set of requirements. While some requirements may be “common” among many countries, others will demand a deep understanding of the local regulations, products, and/or reporting protocols which can be challenging to maintain. Organizations should consider where they have the necessary critical mass of capabilities, and identify jurisdictions with only skeleton local teams where current capabilities may not meet the coming challenge.

- **Global governance model and customer experience.** The regulatory compliance chain is only as strong as its weakest link. Failure at any point may result in both noncompliance penalties and significant reputational damage.

Effective global governance and compliance will require institutions to enhance their oversight tools and capabilities to monitor the myriad
reporting requirements and customer interactions across jurisdictions. Tax operations functions that traditionally focused on single jurisdictions may need to expand their monitoring scope to track an increase in filing deadlines, notices and inquiries from taxing authorities, and requests and notifications to customers.

• **Data quality and availability.** Any organization that reports complex data from multiple locations will never enjoy 100% accuracy, but targeted investments in data quality can help minimize errors.

That’s why it’s critical that companies understand the gaps that exist in their customer or product data and initiate remediation efforts to close those gaps. Prioritizing remediation efforts to focus on only essential data that is in the long-term strategic interest of the organization, such as the tax residency of the customer, can help reduce compliance effort and minimize the number and complexity of data transformations required to meet the reporting requirements.

• **Data privacy and security.** The right safeguards on cross-border data transmission must be in place, regardless of whether the organization uses in-house reporting solutions or a third party.

Taking steps to understand the unique regional requirements for data security, data privacy, and encryption that would allow for centralization of data and processing into hub locations will be critical to defining a cost-effective future state operating model.

**Time to start preparing**

In the coming months, institutions should analyze the impact of CRS reporting on their operating models and consider strategic alternatives.

Simply throwing money or bodies at global tax reporting may not lead to an efficient, long-term solution. Rather, organizations need to learn where they need additional investments in their internal capabilities, and where third-party software or managed services might be preferable.

Just as other components of the back office have benefitted from the rise in managed services, it may be time to consider tax reporting the next feasible candidate for change.

### Resources

- [www.ey.com/FACTA](http://www.ey.com/FACTA)
- [www.ey.com/CRS](http://www.ey.com/CRS)

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