

# The Role of the Board in Risk Management: Case Studies on Tax Risks

Presentation by:  
Robert Waruiru  
Associate Director, KPMG Advisory Services Limited  
CPA-K  
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# Introduction: Risk defined

# Introduction: Risk Defined



- Risk as a noun:

“A situation involving exposure to danger”

- Risk as a verb:

“expose someone or something valued, to danger, harm or loss”

- Risk as defined by the Capital Markets Authority (CMA) in Gazette Notice No. 1420 of 2016:

*“The quantifiable likelihood of loss or less-than-expected returns”*

- Risk involves an element of uncertainty and the future

# Tax as a concept: Tax...



- ...is the monetary contribution levied on each citizen to finance operations of government
- ...is the price we pay for living in a civilized society
- ...is an exaction...it is very taxing!
- ...generally attracts very punitive sanctions
- ...is a source of conflict
- ...is here to stay...alternative financing?

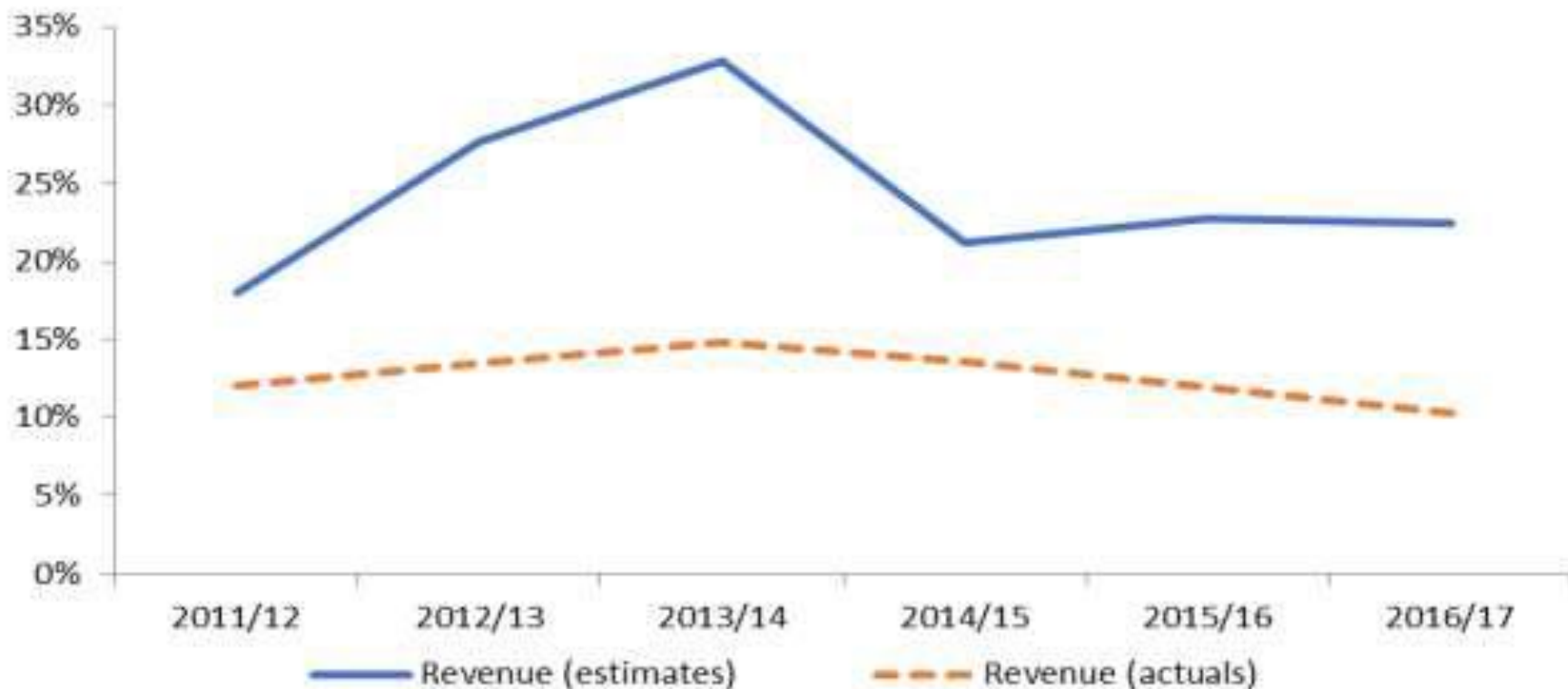
What is tax?



# An ambitious plan...



**Growth Rates of Revenue Estimates and Actuals**



Actual vs Estimated Revenues – the gap.

Source PBO, Aug 2017

# Major risks from Taxation



# Major tax risks



- Financial/operational risk:
  - ✓ At least 30% of the profits go to government
  - ✓ Punitive penalties & interest strain cash flows
  - ✓ Potentially shifts financial obligations eg WHT
  - ✓ Pay to play rules:  $\frac{1}{3}$  rule in Tanzania?
  - ✓ Attaching bank accounts
  - ✓ Garnishee proceedings

What  
does it  
entail?





# Major tax risks



- Reputational risk:
  - ✓ Public opinion – tax dodgers
  - ✓ Higher risk of audits
- Personal liability risk
  - ✓ Secondary liability of persons in authority and CPAs eg in Ethiopia
- Enforcement risks
  - ✓ KRA can charge & auction assets!

What risks exist?



# Tax risks: the complexity?



- Complex tax laws...differing opinions and a more aggressive tax authority
- Constantly changing tax laws...Rental Income Tax Withholding?
- Technical aptitude of front-line staff
- Multi-jurisdictional operations...an example of hybrid mismatches?



# Tax risks: the complexity?



- Complex commercial transactions...the digital economy
- Regular and varied filing requirements
- Obligation to maintain records
- Complex declarations and platforms...*iTax?*

# A Director's obligation

Uphold public interest

# An evolving obligation!



- In the past:

Directors were required to “*exercise reasonable skill and care*”

- Today:

Directors are required to “*employ their special skills and experience to further the company*”



# The Director's obligation



- Duty to act within powers (Sec 142 Companies Act, 2015)
- Duty to promote the success of the company (Sec 143, Companies Act, 2015)
- Duty to exercise independent judgement (Sec 144, Companies Act, 2015)
- Duty to exercise reasonable skill, care and diligence (Sec 145, Companies Act, 2015)...defined as fiduciary duties by CMA

# CMA Recommendation



- *“The Board and its committees shall have the appropriate balance of skills, experience, independence and knowledge of the company and its business, to enable them discharge their respective duties and responsibilities effectively”*
- ✓ Competence to understand & deal with emerging issues
- ✓ Ability to effectively review and challenge management
- ✓ Obligation to define risk policy, identify and mitigate risks



# Case studies...

# SBI International v Amos Hadar



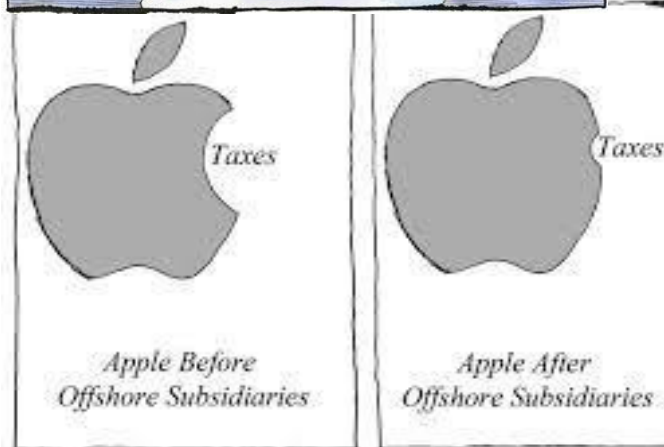
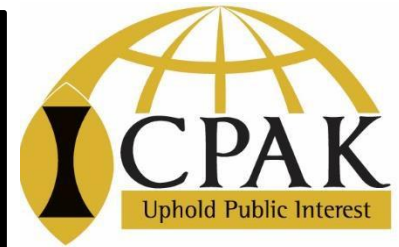
- The former finance manager sued the board for payment of employment arrears where an issue of compliance with expatriate payments and tax arose
- Holding: it was the responsibility of the board to secure tax compliance and directed the Commissioner to investigate tax compliance with expatriate employee taxes

# Cooperative Bank Ltd v Erastus Mureithi



- The former MD sued the bank for service benefits which the bank claimed was part of tax which the MD had failed to remit while acting as director
- Holding: the responsibility to make tax deductions lay on the board and not on the MD

# The commercial view – global angle



- Source(<https://www.icpak.com/wp-content/uploads/2017/05/Presentation-on-tax-risk-and-compliance-Ibikunle-Olatunji.pdf>)

# Some other notable cases...



Walter Anderson:

- Made money in the breakup of AT&T
- Alleged to have evaded over USD 200m
- Sentenced to 9 years

Al Capone

- Convicted on a tax fraud charge and served 11 years in jail

# Some notable cases...



Paul Daugardas:

- Helped clients evade taxes through fraudulent tax shelters that created fictitious tax losses
  - Alleged to have evaded over USD 1.6 bn
  - Sentenced to 15 years
- 
- Source: <http://tax.findlaw.com/tax-problems-audits/famous-tax-evasion-cases.html>

# Some notable cases...



- HMRC fraud investigations led to 762 individuals, who were involved in tax crimes, being convicted in 2017
- These convictions resulted in more than 1,000 years of sentences being dished out by the courts
- Livio Mazzarello and Louisa Mbadugha evaded £46.5m in tax by smuggling wine into the UK. Sentenced to a total of 17.5 years in prison
- Source: <https://international-adviser.com/hmrc-reveals-top-10-tax-fraud-cases-2017/>



# Tax Risks:

## A Director's Take-away

# The Director's obligation in respect of tax risks



- Involve specialist tax advice
- Consider cross-border implications eg transfer pricing
- Consider all taxes including transactional taxes
- Any disclosure requirements for the tax position taken?
- Review the cost-benefit analysis of the tax position
- Post-implementation review and follow up?
- Effective Tax Rate (ETR) and a comparison with competitors' ETR?

# INTERACTIVE SESSION

