Chapter 12

Managing the Current Risks of Companies:

The Applicability of Tax Risk Management

Feride Bakar Türegün
https://orcid.org/0000-0002-2611-292X
Bursa Uludag University, Turkey

Adnan Gerçek
https://orcid.org/0000-0002-9495-2429
Bursa Uludag University, Turkey

ABSTRACT

The taxation power of governments affects companies' business activities. For this reason, the legal limit of tax law must be known by taxpayers. Uncertainty, frequent changes, and interpretation differences in the tax field and reporting reveal tax risks. Today, companies, especially large ones, accept tax risk as a part of the risk management process. Focusing on tax risk management, this chapter presents the discussions on various definitions of tax risk and on the tax risk categories, factors that affect tax risk. The applicability of tax risk management is evaluated from the following perspectives in the chapter: empirical analyses conducted in different countries, tax control framework, and tax risk management practice in various countries. As a result, tax risks are manageable with the support of cooperative compliance models of revenue administrations in countries, the necessity of corporate governance principles, the situation of legal regulations, and the increasing risk management experience of especially large companies.

INTRODUCTION

Recently, corporate governance and risk management issues were more emphasized with financial crises and corporate failures and frauds. Tax is also an important and manageable risk area in the financial indicators of companies. On the one hand, international accounting firms conducted studies about tax

DOI: 10.4018/978-1-7998-8609-9.ch012

risk and its management, and then large companies were interested in the subject increasingly. On the other hand, tax administrations in many countries revised their audit selection strategies to collaborate with large taxpayers by "co-operative compliance" which involves understanding taxpayers and guiding them to the correct applications (OECD, 2013: 13). These two different approaches both conflicted and supported each other mutually.

In parallel with the growing importance of the subject, it should be discussed in detail. When examining previous studies on this topic, the study edited by Khwaja et al. (2011) observed that the issue was mainly discussed from the tax administrations' perspective. This study is critical because it deals with the experiences of different countries and guides the determination of the legal tax area in these countries. But tax risk must also be approached from the perspective of taxpayers. Therefore, some studies from this point Elgood et al. (2004), Henehan and Walsh (2008), and Bakker and Kloosterhof (2010) are important. In addition, researches have turned to empirical analysis of the in-depth interviews' results with tax managers over the past ten years. But these studies are insufficient to explain the applicability of tax risk management thoroughly as a new area and to discuss the current tax risks. The purpose of this study is to describe the types of tax risk, to determine the aims of tax risk management and its place in risk management, to examine the factors affecting tax risk and effects of the pandemic, to discuss the situation of tax risk management from different perspectives in various countries and finally to present applicability of a tax risk management for companies. The structure of the study is as follows. Primarily, the theoretical background and a description of "tax risk" and "tax risk management" will be explained due to archival research in the literature. Then, factors affecting the level of tax risk will be argued in detail, and tax risk management practices in various countries will be presented. The applicability of tax risk management will be discussed based on the theoretical and country practices in the final section.

THEORETICAL BACKGROUND OF TAX RISK MANAGEMENT

Risk, Risk Management and the Role of Tax Risk Management

The taxation power of governments affects companies' business activities. For this reason, the legal limit of tax law must be known by taxpayers. Risk is defined as "anything negative that can affect the organization's ability to achieve its objectives" (EC, 2006: 13). The concept of "risk" can be identified as the likelihood and magnitude of different outcomes than expected (Neubig & Sangha, 2004: 114). If there is a risk, people care about the outcomes, and they don't know what will happen. It seems that risk entails two essential components: exposure and uncertainty (Holton, 2004: 22). Because of these two factors, risk including in the tax area, must be managed. Risk management is defined as determining risk areas in an organization and replying to them appropriately (Merna & Al-Thani, 2008: 2).

With the effect of the financial crisis and the corporate failures and frauds, companies have become more interested in corporate governance with internal control and risk management than before (Daelen et al., 2010: 1). From the 1990s, focused on internal controls and risk and then faced the frauds, started corporate governance in tax authorities are very important to understand where is tax risk management in the corporate management process (Henehan & Walsh, 2008: 11-20). Managers, boards, shareholders and other stakeholders of companies interact in the corporate governance process in which companies' goals are determined, the steps to be followed to achieve them, and performance is monitored (OECD, 2015: 9). Companies that want to achieve their corporate governance goals also use risk management

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