

SME RISK MANAGEMENT

Identifying and mitigating key tax risks for SMEs, SMPs
and their advisors

Facts and checklists

FACTS.

**SME
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HIGHLIGHTS

Navigating the complexities of tax systems is one of the most challenging aspects of running a business for many SMEs. Many SMEs rely on the services of their accountant to meet their compliance obligations, effectively mitigating their tax risks.

Failure to meet what are often complex rules can result in potential severe financial penalties, and increasingly reputational risks, for both the SME and their SMP advisor.

In this paper we will:

- Examine recent developments in the tax landscape
- Identify the key risk areas that can impact SMEs and their advisors
- Consider how these risks can be mitigated

Many SMEs are only concerned with their national tax systems and there is very little harmonisation of national tax systems across Europe - however, we have identified some common aspects of tax risk. These common areas have been reflected in checklists within this document, which should be customised for local specificities.



INTRODUCTION

For many companies, and especially SMEs, dealing with the complexities of the tax system is one of the most challenging aspects of doing business. It is a highly technical area, subject to frequent changes, and failure to properly deal with taxation obligations can have severe financial consequences.

The burden of tax compliance is disproportionately heavy for SMEs. A 2022 [study](#) concluded that total enterprise tax compliance costs amounted to 30.1% of tax revenue collected for micro-entities, 15.6% for small entities and 8.8% for medium sized entities. This compares to 5.9% for large entities. For the smallest entities, this cost is fairly evenly split between the costs of complying with payroll tax, VAT and corporate income tax obligations - at around €2-3 000 for each tax per annum for micro-entities.

The same study indicated that the smallest businesses outsource more of their tax compliance obligations than larger businesses do. This means that the complexities of tax systems directly impact their tax advisors, whose work may be carried out by professional accountants in small or medium practices (SMPs).

SMES CAN USE SMPs TO MITIGATE TAX RISKS

Consequently, the risks of interacting with increasingly complex tax systems are often at least partly borne by SMPs on behalf of their SME clients. This is particularly the case with cross-border business - which has been facilitated for SMEs by technological developments but which places SMPs at risk from dealing with aspects of other tax systems with which they may not be familiar.

Both SMEs and their SMP advisers should consider risk-management techniques to mitigate the financial and reputational risks that could arise from non-compliance with tax obligations.

This paper – part of our [SME risk management series](#) – aims to highlight how SMEs and their SMP tax advisers face tax risks from different areas and the possible outcomes of not identifying and hence not mitigating such risks. It explains recent developments in the tax environment that affect both SMEs and their advisers.

Using the approaches of several tax authorities, it contains checklists for typical tax risks. Practitioners can customise the checklists to better identify the tax risks that could impact their clients and client specific risks that could impact them.

TAX RISKS IMPACTING SMES

CONSEQUENCES OF NON-COMPLIANCE

FINANCIAL RISKS

The most obvious risk for SMEs that are non-compliant in their tax affairs is financial – for example, in interest or penalties charged for failure to report and / or pay the correct amount of tax, and additional professional fees for regularisation of a client's tax affairs. This risk affects both the SME entity and, potentially, the responsible individuals within that entity.

REPUTATIONAL RISKS

Of increasing importance is reputational risk. Failure to comply with tax obligations could lead to a worsening of the relationship between the taxpayer and the tax authority, which could result in a higher likelihood of tax audits. If breaches become public, this could result in a negative impression of the business, the entrepreneur and even the business' staff. This in turn could have financial consequences – such as the financial costs arising from an increased incidence of tax audits or the loss of customers.

LOSS OF FREEDOM / CRIMINAL RISKS

The final risk is the loss of freedom where the non-compliance is so severe that the penalty is imprisonment – for example, in cases of tax evasion or tax fraud. As SMEs are often reliant on the services of the proprietor or a few key individuals, the loss of these key individuals could ultimately cause business failure.

These risks are the potential consequences that face the entrepreneur or SME for non-compliance.

SMES FACE A VARIETY OF TAX RISKS

LIFECYCLE RISKS

- Start-up – ensuring correct registrations, treatment of research and development expenditure, tax treatment of funding options etc.
- Taking on first employees – employee tax registration etc.
- Expansion – moving into different tax brackets, withdrawal of simplified tax procedures, cross-border trading issues (including cross-border employment or the use of cross border agents), acquiring capital assets etc.
- Business disposal or succession – often highly complicated from a tax perspective

STRUCTURAL RISKS

- Inadequate accounting and / or tax reporting systems:
 - Especially in terms of meeting regular return filing and payment deadlines
 - Failure to keep adequate evidence to support the information included in the filed tax returns
- Management time pressures lead to administrative requirements being sidelined
- Lack of internal knowledge in respect of the operation of tax systems
- Lack of segregation between the entrepreneur's personal life and the business.
- Inadequate insurance to protect the business from the above risks – where possible.

OPPORTUNITY RISKS

- Tax can be overpaid, resulting in less working capital to invest in the business, for reasons including:
 - Failure to use tax simplifications for small businesses or start-ups
 - Incorrect structuring of the business
 - Failure to optimise the funding of the business
 - Failure to use tax allowances or incentives – for example, for research and development
 - Not using the most tax efficient manner to acquire business assets
 - Not using an optimised structure for remuneration of staff and management.

RISKS FACING SMPS

As mentioned above, it is very common for SMEs to outsource at least some of their tax compliance to their tax advisors and / or professional accountants, who usually work in small or medium-sized practices. This is

an effective risk management strategy for SMEs as inserting a tax professional in the tax compliance process shares an element of the SME's tax risk, at least in respect of genuine errors.

Consequently, the accountant faces risks from some of the same elements that would impact their clients – especially the structural risks, such as poor accounting systems and practices and a lack of segregation between private and business expenditure.

The SMP also faces a risk when asked by their clients to deal with aspects of the tax system where they have had little or no previous experience, which are technically complex or result from new legislation. Failure to adequately address this risk would put the SMP in breach of a fundamental principle of the [IESBA Code of Ethics for Professional Accountants](#) and may result in financial costs should the advice provided subsequently prove incorrect or inadequate.

RISKS FACING EXTERNAL PROVIDERS OF SERVICES

However, the SMP advisor / accountant also faces additional risks that arise from being an external provider of services and consequently not having a full picture of the SME's business model, the entrepreneur's plans or the role that the business plays in broader financial aspects of the entrepreneur's family. This could introduce risks related to, for example:

- Failure to perform adequate due diligence / Know Your Client procedures for new clients, which may be in breach of local laws and could also impair the SMPs ability to properly advise the clients
- Insufficient knowledge of the client's risk appetite in respect of financial matters – especially an issue with new clients
- Incorrect assumptions about the client's prime business drivers (for example, assuming profit maximisation and tax minimisation are the key drivers), - increasing the risk that advice will be given that is not in accordance with the client's long-term objectives
- Inadequate knowledge of the taxpayer's sources of wealth– this introduces both potential tax risks and anti-money laundering compliance risks
- Proposing tax solutions based on immediate short-term concerns without knowing the bigger picture
- Advising on only one side of the tax problem – this can be a particular concern for cross-border transactions where the SMP may be asked to provide advice only for their jurisdiction
- Failure to acquaint the client with all possible legal solutions - including an honest assessment of the risks inherent in the solutions. This is a legal requirement in some countries but even in those countries where no legal requirement exists, failure to present all alternatives could result in legal action by the client

RISK OF CHANGING CLIENT CIRCUMSTANCES

Even assuming the SMP has good knowledge of the client, the client's affairs and their attitude to risk may change over time - bringing the risk that existing tax planning arrangements are no longer optimal or even relevant. For example, the client may become more risk averse so tax mitigation arrangements previously considered acceptable may become undesirable. Another example could be a change in the client's original intention to build the business to sell for profit to wishing to pass the business on to family members – potentially requiring a change in tax strategy and perhaps even a review of the business' legal structure.

These considerations are quite apart from the requirement to keep up to date with changes in tax legislation, imposed, for example, by revisions to the Code of Ethics for Professional Accountants (as described in the next section).

RISK OF CLIENT MALFEASANCE

SMPs are also at risk should their SME clients be found to have committed tax evasion and / or fraud. An SMP found to have been associated with an instance of non-compliance with laws and regulations ([NOCLAR](#)) will face reputational harm and there can also be penalties if the SMP failed to alert the appropriate authority to suspicious activities of which they were aware (or could be deemed to have been aware), should this be a legal requirement in the particular jurisdiction.

This would include preparing and / or submitting a tax return based on deliberately false underlying data – such as suppressed income or personal expenses included as tax deductible items.

REPUTATIONAL RISK

There is now far more scrutiny of taxpayer behaviour in many European countries – both from the point of view of tax authorities and also from the public.

ANTI-AVOIDANCE LEGISLATION

There has been a large increase in anti-avoidance legislation at international, European and national levels. This is often directed at corporate income tax avoidance by MNEs but has affected other taxes and taxpayers as well. For example, an increasing number of jurisdictions have implemented general anti-abuse rules (GAARs) – including all EU Member States – that effectively require that all tax planning and mitigation arrangements demonstrate genuine commercial substance.

There has been a large increase in automatic exchange of tax information across borders that makes it increasingly difficult to evade tax by remitting funds to other countries. Leaks to the press about tax avoidance structures have frequently cast tax professionals in a negative light and more and more tax authorities are monitoring the advice given by tax professionals, including accountants.

THE ACCOUNTANCY PROFESSION'S AND IESBA'S RESPONSE

The accountancy profession has responded by emphasising that consideration of the public interest is a key issue for tax advisors and professional accountants. Specific codes of conduct have been issued by professional bodies in some countries to address these concerns. Accountancy Europe issued its 2017 paper [*The Role of Professional Accountants in Tax*](#) to set out what professional accountants should take into consideration when providing tax advice to their clients.

The International Ethics Standards Board for Accountants (IESBA) issued its revision to the Code of Ethics for Professional Accountants to specifically address ethical issues arising from [*Tax planning and related services*](#). This applies to professional accountants, and firms of professional accountants from 1 July 2025 and is covered in more detail in a separate Accountancy Europe publication [*IESBA code revisions on tax planning – key changes for accountants*](#).

MOVING TOWARDS IMPROVED COOPERATION

Apart from strengthening anti-tax avoidance and evasion tools, some tax authorities are making efforts to improve their relationships with taxpayers and the taxpayers' professional advisors – often around improving communication and transparency.

In Appendix 1 we have highlighted some of the many national initiatives to improve the communication and cooperation between tax authorities, taxpayers and their advisors

Appendix 1a) highlights the French Finance Ministry's [*L'examen de conformité fiscale*](#). This allows a business to engage a professional advisor to certify a limited number of points in respect of their tax filing. The benefit for the taxpayer is that if a subsequent tax audit identifies errors, there is, at a minimum, a waiver of interest and penalties.

Appendix 1b) summarises advice from the Australian Tax Office on how businesses should manage tax risks.

Appendix 1c) summarises some of the internal manuals and checklists published by the UK's HMRC so that taxpayers and their advisors consider key risk areas or areas of difficulty before submitting tax returns.

OTHER NATIONAL INITIATIVES

Greece also permits companies to obtain a voluntary Annual Tax Compliance Certificate, requiring a special audit conducted by certified auditors or audit firms to confirm a company's compliance with tax provisions for a given fiscal year.

In Italy the co-operative compliance regime is being extended to include smaller entities (to entities with revenue of 100 million euro or more in 2028) but there is no clear indication that the programme will be extended to cover SMEs.

Elsewhere, accountants and certified tax advisors are required to certify elements of the national tax regime. This certification can enable faster refunds and prove entitlement to specific tax incentive programmes. However, such requirements also can expose both the taxpayer and the certifying professional to tax risks of administrative sanctions and potential criminal liability where issues are subsequently identified.

For example, Italy's Visto di Conformità tax compliance certification is required in certain circumstances – such as for large VAT refunds, for offsetting credits in one tax against another and for applying for certain discounts or tax incentive schemes. The certification can be provided by qualified professional accountants and certain other tax professionals.

Romania also specifically requires the certification of tax returns by a registered tax consultant.

PRO-FORMA CHECKLISTS TO IDENTIFY SIGNIFICANT TAX RISKS

Tax systems for SMEs in the EU are still largely dependent on national law, which is far from homogenous - especially in respect of direct taxes. Therefore, mitigating tax risk will be highly dependent on the jurisdiction, or jurisdictions, involved. However, there are certain elements that occur in many tax systems, and we will draw on examples of national initiatives that may be more broadly applicable.

The checklists presented below only highlights issues that **may** be relevant and should only be used as a basis for the SMP to prepare their own checklist based on their assessment of the key tax risks arising from domestic tax legislation.

Questions to be considered	Tax risk	Yes	No	N/A
CLIENT TAX RISK ASSESSMENT FOR SMPS – GENERAL RISKS APPLICABLE TO MOST TAXES				
Is the client new to the practice?	SMP will have no past experience of the client's compliance record, willingness to accept tax risks, sources of funds, overall financial picture etc			
Is the client in a specialist business sector where the SMP has no prior experience?	Some sectors have very specific tax treatments of which the SMP may have little or no prior knowledge			
Is the proposed tax arrangement novel to the SMP?	Whilst the SMP may be fully acquainted with the relevant law, lack of prior practical experience with the arrangement increases the risk that implementation of the arrangement may be incorrect			
Does the client have other accountancy or tax advisors who will continue to be engaged during the SMP's engagement?	The SMP may not have the full financial, business and tax picture of the client's affairs. The client may be doing this deliberately to assist in tax evasion etc			
If the client does have another advisor, have they refused permission for the SMP to contact that advisor(s)?	This causes issues with professional courtesy and also limits the SMPs ability to provide effective, tailored advice to the client. It could also indicate a deliberate attempt by the client to ensure no professional advisor has the complete picture of the taxpayers' affairs			
Has the client previously been subject to a tax audit that resulted in additional tax liabilities? If so, has the client failed to rectify the issues that were identified during the audit?	A prior tax audit may indicate ongoing tax risks, particularly if the audited client was targeted and the client has not made appropriate changes to address the issues that were identified by the tax auditor			

Have the client's circumstances, long-term objectives, risk attitude etc changed?	This could mean that extant tax planning advice and arrangements are no longer appropriate for the client			
Has the existing client introduced new business partners, obtained significant external finance from outside parties unknown to the SMP etc?	This may mean that the Know Your Client information is now out of date and needs to be updated. If new business partners also bring in new funds, the source of those funds will need to be established to avoid AML risks and tax risks			
Is the client suffering profitability and/or cash flow issues?	This may indicate an increased willingness by the client to, for example, suppress income to reduce tax liabilities or delay submission of returns and delay payment of tax liabilities			
Does the client have a willingness to take tax risks, always push for the SMP to reduce tax liabilities, have a lax attitude to compliance etc?	This could indicate an increased likelihood that the client would be willing to suppress revenue etc. It also increases the risk that the SMP will be put under pressure to be involved in tax planning strategies that it has little experience in or run a high risk of controversy with tax authorities			
Are there frequent and persistent failings in the client's accounting and / or document storage systems?	This will increase the tax risk of underreporting income and over-reporting expenses and of returns being incorrect			
Is there a lack of defined responsibilities and control over the reporting function generally and specifically as it pertains to the tax function?	Again, this increases the risk that tax reporting will be inaccurate and that deadlines will be missed			
Does the management frequently override accounting systems and controls?	This increases the possibility of accounting and tax records and reporting being incorrect and of deliberate manipulation of taxable profits			
Is it common for management to manually change or delete recorded transactions or enter new ones – especially close to reporting dates?	This increases the possibility that management are deliberately manipulating profitability and tax liabilities			
Do the business owners have little distinction between the business and their own private affairs?	This increases the risk that personal expenditure will be recorded as a business expense and increases the risk that the business owner will face tax and other charges for personal usage of business assets			
Does the client have overseas business, assets and liabilities?	A significant presence in another country increases tax risk as the SMP is not often present in the other jurisdiction, may not even be aware of assets etc in another jurisdiction that could have a significant tax			

	<p>impact in their jurisdiction. The risks are considerably increased when the other jurisdiction is considered non-compliant.</p> <p>Additionally, the rules relating to the taxation of overseas income and assets may be complicated (for example, double tax relief), increasing the risk of error</p>			
Does the client have transactions or arrangements where there is a disconnect between the legal form and the commercial substance and / or where steps appear to have been added making the transaction or arrangement more complex than necessary	<p>This could indicate a deliberate attempt to evade taxes or that a complex tax avoidance scheme has been implemented in the grey zone of acceptability and which may increase the risk of a tax audit or investigation</p>			

TAX RISK ASSESSMENT FOR SME CLIENTS – SPECIFIC RISK AREAS FOR INDIVIDUAL TAXES

The following topics are highlighted by certain tax authorities as areas they consider to be of risk – both in terms of errors and in terms of potential manipulation. They do not, however, apply in all jurisdictions and the list below should be revised to take into account local tax law.

Advisers should confirm whether these circumstances apply to their clients, whether their clients (and the advisor) have the technical knowledge to correctly apply the rules and whether the risks are adequately managed.

BUSINESS AND CORPORATE INCOME

Common risk areas identified	Potential tax risks
Related / connected party transactions and transfer pricing	Related party transactions can be used to shift taxable profits. They are often a source of concern to tax authorities – especially when one party to the transaction is in another jurisdiction
Proper application of the accruals basis, stock provisions and other significant year-end adjustments	Income and expenses may not be recognised in the correct accounting / tax period potentially leading to tax liabilities being understated or overstated
Correct allocation of items to capital or revenue	Taxable profits may be misstated
Correct application of business losses	This is often a complex area with restrictions on the use of losses being common (particularly in respect of losses incurred on capital items) and different ways of utilising the same losses may be possible. The use of losses within a group can be complex as can losses on assets used by connected parties. Failure to deal with these complexities could result in miscalculation of the tax liability or overpayment of tax for businesses facing financial stress
Transactions with directors / owners and directors' / owners' loans accounts	Tax risks could occur due to claiming personal expenditure as business expenditure, using an inappropriate interest rate on loans with directors / owners and the inclusion in the business accounts of assets used for business and private purposes
Employee taxes and social security	<p>This is frequently a very complex area with special rules for non-cash benefits provided to employees, the deductibility of certain business expenses incurred by employees (and directors), termination payments etc. It is not uncommon for special specific tax advantageous regimes to be offered by governments. Tax optimisation schemes based around loopholes in legislation are also not uncommon in this area</p> <p>The tax risks not only include those that the business may face from making incorrect returns but also those that may impact on the employee.</p>

Tax depreciation / capital allowance of capital assets	Tax risks could arise from whether the asset qualifies for tax depreciation, the use of incorrect depreciation rates, incorrectly calculating adjustments for personal usage of assets. Tax risks could also arise by, for example, failing to correct use preferential regimes for environmentally friendly assets, for example
Cross-border issues	For SMEs, cross-border tax issues often revolve around cross-border employment contracts, issues of permanent establishment and use of agents. For some SMEs with overseas subsidiaries or branches, there could be transfer pricing risks
VALUE ADDED TAX (VAT)	
<i>Common risk areas identified</i>	<i>Potential tax risks</i>
When and where registration is required, and reclaiming VAT incurred before registration and after de-registration	<p>There is a risk that businesses are liable for charging VAT on their supplies without realising that they have breached the VAT registration limit (if one exists) – leading to a potential loss of margin when the output VAT is accounted for</p> <p>There is a risk that a business will fail to claim the appropriate amount of preregistration input VAT or be subject to unexpected VAT charges after deregistration if the rules are not correctly followed</p>
Errors in VAT recovery	<p>There is a risk that businesses claim normal input VAT deductions on items that have specific rules that forbid recovery or reduce the amount that can be recovered, such as on:</p> <ul style="list-style-type: none"> • Exempt supplies • Business entertainment • Luxury items • Second hand goods • Items without a valid VAT invoice
Apportionment of input VAT on inputs used for both business and non-business purposes	Tax risks occur if an incorrect or undocumented apportionment percentage is used to recover input VAT for purchases or assets that are used for both business and non-business purposes
Application of the correct VAT rate	Where a business operates in a sector where reduced or zero-rated (or an exemption with a right of deductibility of VAT) supplies are possible (for example, supplies of foodstuffs, reading material and construction services) tax risks arise from a misstated VAT return which is submitted where an incorrect rate of VAT is applied. The rules of what supplies are subject to a reduced rate (or an exemption with a right of deductibility of VAT) are often specific and complicated

The correct operation of special schemes – such as margin schemes, flat rate schemes, special schemes for non-established taxable persons and for electronically supplied services	Tax risks arise if the business incorrectly uses a special scheme to which it is not entitled, if it fails to use one where it is obliged to or if it breaches the detailed rules that apply to the scheme
Supplies of land and buildings, supplies of a licence to occupy land and buildings	<p>This is a complex area of VAT and tax risks arise from many different considerations, including:</p> <ul style="list-style-type: none"> • What constitutes a taxable supply • Whether to opt to tax / whether a property has an option to tax exercised • The VAT treatment of renovations and preparation work • Whether the capital goods scheme applies • The VAT treatment of short-term accommodation.
When the business makes a combination of taxable and exempt supplies (partial exemption)	Tax risks occur from areas including the miscalculation of any de-minimis tests, miscalculation of deductible input VAT on overheads and inappropriate use of a non-pro-rata based special method for the calculation.
The non-taxation (VAT) on a transfer of a going concern	<p>The tax risks in this area arise in such areas as:</p> <ul style="list-style-type: none"> • Whether the transfer meets the requirement to be an entire business or a part of a business capable of separate operation • Whether the purchaser is registered for VAT.
VAT and cross-border transactions	<p>There are many tax risks that are present in cross-border trading. Particular care must be taken, for example with:</p> <ul style="list-style-type: none"> • Documentary evidence supporting the movement of goods across borders within the EU • The place of supply rules, which are different for goods and services, for electronically supplied services and for distance sales • The possible need to register for VAT in other jurisdictions • The correct application of the rules of the particular one-stop shop that is appropriate for the business • The use of the correct VAT rate when goods or services are taxable in the country of destination • Special arrangements for call off stock and VAT triangulation • Recovery of input VAT suffered in other jurisdictions • Implementation of changes to be introduced by VAT in the Digital Age (ViDA).

CAPITAL TAXES

<i>Common risk areas identified</i>	<i>Potential tax risks that could arise</i>
<p>Capital taxes are often event-driven (e.g. the disposal of an asset, death etc) rather than driven by annual assessment. Consequently, taxpayers may not be aware that a chargeable event has occurred.</p> <p>Additionally, a lot of pertinent information and documentation could derive from actions in the distant past – such as original acquisition cost, costs of enhancement work, partial sales, gifts etc</p>	<p>Tax risks could arise from failure to make a return or from failure to keep accurate records and supporting documentation of all the elements of the transaction.</p>
<p>Capital taxes often involve some element of valuation. Valuations are an area often considered to be high risk by tax authorities</p>	<p>Tax risks arise when open market valuations are unavailable and a valuation is returned that is not adequately supported by documentation.</p>
<p>Use of trusts</p>	<p>Where the law of a jurisdiction permits the use of trusts, or an equivalent vehicle, there are often complicated rules about disposal of assets held in trusts. Equally, when a beneficiary of a trust dies, there may be a tax charge based on their beneficial ownership and, again, the rules tend to be complicated and of a specialist nature. Tax risks in this area are considerable</p>
CAPITAL GAINS TAX	
<i>Common risk areas identified</i>	<i>Potential tax risks that could arise</i>
<p>Disposals of land and buildings</p>	<p>Potential tax risks can occur in relating to disposals of land and buildings as a result of:</p> <ul style="list-style-type: none"> • Identifying the date of disposal for conditional contracts and where law dictates that disposal takes place at a time that may not be that of the completion of the contract • Valuations, particularly when produced by a non-qualified surveyor. Additionally, it is possible that some elements that could affect the value are not passed to the qualified valuer – such as development value, the existence of tenancies, the inclusion of intangibles or other assets and the existence of restrictions over the asset • Certain expenditure on the asset may not be deductible from the capital gain • Incorrect application of any specific reliefs that may be available
<p>Disposal of shares, businesses and personally held business assets</p>	<p>The main tax risks arise for disposal of unquoted shares and business assets and could include:</p> <ul style="list-style-type: none"> • The valuation of shares etc where the disposal is made other than for cash considerations

	<ul style="list-style-type: none"> • Incorrect application of specific reliefs for example, any reliefs granted on gifts of business assets or where the proceeds of disposal of a business asset are reinvested into another business asset • Certain subsequent expenditure on the asset may not be deductible from the capital gain
INHERITANCE TAX	
Assets or life events may be omitted, often because the persons involved in managing the will may be unaware of the full history of the deceased	<p>Task risks arise from, for example:</p> <ul style="list-style-type: none"> • Failure to disclose assets that are not obvious to the executor of the will – particularly in respect of assets overseas or interests in trusts, for example, where a document trail may be incomplete • Inheritance tax on death can also include life-time transfers of assets. It may be difficult to identify such transfers where record keeping by the deceased is not complete
Valuation of assets and liabilities at the date of death	<p>This is cited by some tax authorities as the single largest element of tax risk for inheritance tax. As it is frequently the case that assets are transferred rather than sold, ascertaining a value at the date of death can be very difficult, especially for those assets that don't have a readily available market valuation</p> <p>Even if assets are sold, it is frequently at a later date and is probably not the same as the value at the date of death</p> <p>Some tax authorities recommend that professional valuers are used</p>
Use of available reliefs	<p>Jurisdictions may offer nil-rate bands and exemptions and possibly reliefs for specific assets, such as business assets</p> <p>These reliefs have very specific rules and tax risks arise if reliefs are incorrectly claimed. The infrequent nature of inheritance tax for the non-specialist increases the tax risks</p>

APPENDIX 1 – EXAMPLES OF ASSESSMENT OF TAX RISK BY SPECIFIC TAX AUTHORITIES

A) THE FRENCH MINISTRY OF FINANCE'S EXAMEN DE CONFORMITÉ FISCAL (ECF)

The French Finance Ministry introduced [L'examen de conformité fiscale](#), that allows a business (from 2021) to engage a professional advisor to certify certain points in respect of their tax filings, in return for:

- a better relationship
- enhanced tax certainty
- and a possible abeyance of penalties if errors are subsequently discovered in respect of an aspect that has been audited.

The law lists 10 points that service providers should review when reviewing their client's tax compliance. Two of these are specific to the electronic format of information to be provided during a tax audit but the following review points cover areas that may be broadly applicable:

- the quality of the accounting entries with regard to accounting principles
- compliance with the rules on the time limits and the method of retention of documents
- validation of compliance with the rules related to the tax regime applied (simplified regime, normal regime, etc.) in terms of corporate income tax and VAT with respect to the nature of the activity and turnover
- the rules for determining depreciation and its tax treatment
- the rules for determining provisions and their tax treatment
- the rules for determining accrued liabilities and their tax treatment
- the qualification and deductibility of exceptional charges
- compliance with the tax point rules in terms of VAT (both for VAT collected and deductible VAT)

In the event of a subsequent tax audit, no penalties or interest on any undeclared taxes will be charged if:

- the audit relates to items validated in the ECF; and

if the company acted in good faith.

B) AUSTRALIAN TAX OFFICE

The Australian Tax Office (ATO) has detailed guidance on how businesses should manage tax risks, including early communication with the ATO about potential contentious tax treatments.

The ATO also provides considerable [guidance](#) for SMEs in how to implement a tax control framework. It highlights that the concepts are similar for larger businesses, but the formality of the controls may vary – and documentation of controls may be lacking. It also acknowledges the active role of senior management / owners in such areas of granting credit to customers and approving certain purchases can provide effective control that obviates the need for more formal controls.

In its opinion, the main control activities should be focused on the main transactional cycles i.e. revenue, purchases and employment costs.

It also highlights that the active involvement of the owner manager can increase some risks through the override of controls.

It is proposed that the business can demonstrate its commitment to control over the tax function by performing a risk analysis to identify the significant transactions that can impact tax and developing policies to cover these risk areas.

It highlights the following typical risk factors covering all areas of tax (those that could also be applicable in other jurisdictions) that businesses should consider:

- those transactions of such high volume that they significantly affect disclosures in tax returns
- those transactions where there are complexities and inconsistencies between financial accounting and tax reporting
- transactions subject to frequent manual adjustments made by management
- related-party transactions
- transactions involving low-tax jurisdictions
- year-end arrangements or adjustments resulting in tax benefits
- revaluations resulting in tax benefits
- transactions or arrangements where there:
 - is a disconnect between the legal status and the commercial substance
 - are steps added to a transaction making it more complex than necessary, resulting in a tax preferential outcome
- the use of new and complex financial instruments or arrangements
- manual coding and classification of transactions for VAT and excise where systems were overridden
- intra group transactions within VAT groups
- reversals or corrections to filed tax returns or transaction reports
- experiencing rapid growth, which may lead to incorrect reporting if the tax governance framework isn't fit for purpose to support the expansion
- expanding operations to include offshore transactions or engaging in cross-border transactions with related parties
- considering using wealth extraction structures or considering tax efficient structures to pass on wealth to the next generation
- Tax planning arrangements or other issues that the tax authority has identified to all taxpayers or relevant categories of taxpayer as being disputed or under investigation

The ATO also identifies [7 principles of effective tax governance](#).

These are:

- Principle 1: Accountable management and oversight – including clearly defined roles and responsibilities for tax administration. Where this is shared with tax advisors, management must still be aware that they are ultimately responsible and where the demarcation of duties lie

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- Principle 2: Recognise tax issues and risks – ensuring that material transactions are well documented and subject to appropriate review and authorisation. Where tax risks have been identified, there should be a plan to manage the risks
 - Principle 3: Seek advice – if offered by the tax authority, follow available guidance and contact them for advice where available. It would also apply to consulting external advisors, such as their accountants
 - Principle 4: Integrity in reporting – systems and controls should be in place to ensure accurate financial and tax reporting. Where tax outcomes differ from financial reporting outcomes, systems should be in place to identify why those differences arise
 - Principle 5: Professional and productive working relationship – the business should have an open, respectful and professional working relationship with its tax authority
 - Principle 6: Timely lodgements and payments – timely filing of returns, payments on account and other tax payments is a demonstration of effective tax governance
 - Principle 7: Ethical and responsible behaviour – businesses should act with honesty, integrity and in a way consistent with the expectations of the broader community and the taxpayers' charter

C) UK HMRC TAX AGENT TOOLKITS

The existence of topics on a tax authority's website indicates that this is a potentially risky topic – certainly from the perspective of the tax authority.

<https://www.gov.uk/government/collections/tax-agents-toolkits>

For example, the UK's HMRC has specific toolkits (fundamentally, checklists with links to the relevant legislation and spaces for adding comments) for tax agents such as accountants, covering the main areas of risk in the preparation of tax returns. The topics highlighted below that are covered again indicate common issues for many tax systems:

CAPITAL GAINS TAX TOOLKITS

- Capital Gains Tax for land and buildings
- Capital Gains Tax for shares

For these toolkits, the risks highlighted include using the right date of disposal, obtaining correct valuations of assets, correct deduction of related expenditure and entitlement to specific CGT reliefs

TOOLKITS FOR COMPANIES

- Business profits – risks highlighted include ensuring all income is recorded on the accruals basis, including expenditure that is only for the purposes of the trade, proper valuation of stock and work in progress (especially for construction contracts) and the impact of post-balance sheet events
- Capital versus revenue expenditure - risks highlighted include record keeping, renovation work in the course of acquisition, the treatment of legal and professional fees, IT costs, finance costs and intangible assets
- Company losses - risks highlighted include the overall basis for claiming loss relief, which losses can be utilised against which profits, losses on loans with connected parties, business property losses, losses on intangible assets, use of losses within a group and restrictions on the deduction of interest
- Directors' loan accounts - risks highlighted include the inclusion of personal expenses, the rate of interest charged on loans to/from directors and employees and the payment of benefits in kind and other non-cash payments to directors and employees
- Capital allowances (tax depreciation) for plant and machinery - risks highlighted include whether the asset qualifies for capital allowances either in full or in part, whether a disposal is recognised when the asset is disposed other than for cash and the non-business use of certain assets
- Employer toolkits - risks highlighted include reviewing payments for benefits paid to directors and staff outside the payroll, use of company assets for private purposes, the deductibility of travel and subsistence expenses, payment of employees' personal bills, use of special remuneration arrangements
- National Insurance (social security) contributions and statutory payments – risks highlighted include ensuring that social security charges are added to certain non-cash benefits paid to employees and to termination payment and how certain special schemes are implemented

TOOLKITS FOR INDIVIDUALS (INCLUDING UNINCORPORATED BUSINESSES)

- Private and personal expenditure – risks highlighted include the deduction of entertaining expenses, gifts given and subscriptions and sponsorship that may have a personal element

- Capital allowances for structures and buildings agent toolkit - risks highlighted include whether the building qualifies for capital allowances, whether the allowances need to be apportioned for non-qualifying use and whether residential use prevents the claiming of allowances.
- Foreign income toolkit – risks highlighted include the taxpayer being unaware of the need to report, not understanding what needs to be reported, being unaware that foreign income arises and a deliberate failure to report
- Property rental toolkit - risks highlighted include the income to be included in the return (including non-cash benefits), different treatment of property income from foreign properties, the expenses that can be deducted, the use of certain reliefs, whether capital allowances (tax depreciation) can be claimed and the treatment of property rental losses

INHERITANCE TAX TOOLKIT

- This is a specialist area of tax and arises from circumstances that taxpayers are not usually familiar with. Therefore, tax risks for both taxpayers and their the SMP adviser will normally be higher from the start.
- Specific reliefs for business or agricultural assets - tax risks include ensuring that the asset\business in question qualifies for the reliefs and that all other terms of the relief are met
- The tax is event specific and does not have a year of assessment – as inheritance tax in the UK looks at lifetime transfers, gifts, jointly held property etc. the tax risk arises because the range and depth of information required is exceptional and will often include less obvious assets (such as an interest in a trust) and assets disposed of and not just the obvious assets that the individual held at the date of death. It could be difficult to identify such assets and then obtain the necessary information, particularly if the deceased kept poor records. Advisors could recommend that clients keep records of gifts etc and remind them during the annual tax return process, or in circumstances where the SMP and client are reviewing future plans or other tax planning. Accurate record keeping, including dates of acquisition, enhancement and disposal is essential to avoid future risk of disputes for the taxpayer's executors.
- Valuations – this is one of the main sources of tax risk in respect of capital taxes. This is less of an issue where publicly available sources of information are available (such as prices for quoted equities) but can be a considerable problem when such assets as land and buildings (including perhaps, the family home) and businesses have to be valued. It is important that a professional valuer is engaged for such assets, and they consider all aspects in the valuation process – including, for example, the development value of land.

VAT TOOLKITS

- VAT input tax risk risks include:
 - Apportionment of input VAT incurred for both business and non-business purposes and appropriation for private usage of assets acquired for business purposes
 - Reclaiming VAT on purchases made before registration or after deregistration
 - Reclaiming VAT on business entertainment
- VAT output tax
 - Operation of special schemes – such as margin schemes, capital goods scheme, flat rate scheme etc
 - Treatment of miscellaneous or incidental transactions
 - Application of correct VAT rate

- Credit notes and bad debt relief
- International transactions
- Identifying when an obligation to register for VAT arises
- VAT partial exemption

Inadequate record keeping is highlighted as a risk in all of these areas.



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