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Tax risks sources and consequences as a part of intercultural management at family companies

Abstract: One of the factors determining competitiveness of the companies is an appropriate environment for running a business. Such an environment is a tax system in which companies functioning. On the one hand, it creates many possibilities of tax optimization but on the other hand exposes to a tax risk. An analysis of risk sources and effects of exhibition to tax risk was carried out in this article in the context of intercultural management. Research was conducted using 4 case studies approach and focus group interview method to develop preposition. The purpose of this study was to indicate the tax strategies that are possible to apply in family business, which will cause limitation of tax risk, as well as minimization of tax burdens.

Key words: tax risk, family business, tax consequences, tax service, intercultural management

Introduction

Development of family business encounter many challenges to deal with, such as business financing, management of family finances, or adjustment to tax environment. The last one is especially important, mainly due to the changeability, high degree of complexity and huge consequences resulting from the lack of compliance.

Research on family financial management behaviour evolved in last 30 years. There is growing interest in the issue of how families manage their economic and financial resources [Gunay, Boylu, Bener 2013, pp. 1-35]. Tax risk is particularly important in the family business because there is an emphasis on tax security. Whereas, there are no studies analysing this problem in this context.

It was focused in this study on the presentation of tax risk as an element of family business' management environment. The main goal was to examine the sources of tax risk, the way of management of this risk and consequence of the lack of it.

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There was an attempt to indicate what actions should be taken by the companies in the aspect of tax management, in order to minimize this risk. First of all, research methodology was presented and sample characterized. Then, sources of tax risk and way of its management in the researched companies were presented. Consequences of lack of tax risk were analysed in the last chapter.

Research method and sample characteristic

The growing complexity of family businesses together with concomitant problems require adjustments in methodology to describe and interpret them correctly. This article presents how the quality method based on case studies was applied to provide a thorough description of the process and show the cause-effect sequence [Ruane 2005, pp. 76-77]. The study used the focus group interview method (FGI) in extended groups between 4 and 6 members (managers, family members, decision makers in tax related issues) and the qualitative case study method suggested for family business research by Aranda, Molotla and Nieto [2012, pp. 125-139].

The family businesses which were selected for the purpose of this study were run by at least two generations or by siblings. We define family business follow Jennings, Breitzkreuz and James [2013, pp. 472-489] as company controlled primarily by the family in which at least two family members are employed. Family refers to two or more individuals related by blood, adoption, marriage or marital-like relationship. Given the specific information revealed in this article and the author's commitment to confidentiality, the business units were coded and letter-marked A,B,C,D. All of the businesses have at least 15 years of market experience, are situated in urban areas, have the status of a small or medium size business, and are VAT payers. The first company, coded A is a manufacturer of custom made furniture, which, in addition, provides design and assembly services in Poland and other European Union countries. It is a three-generation family business. The B company is a nationwide manufacturer of clothing and accessories employing three generations. C is a sugar confectionery producer with extended chain of retail outlets in Poland, which employs two generations (father, mother, two daughters). D is a distributor of IT equipment and electronic goods, which also provides services. Launched and managed by two brothers, at its start it received financial support from the father.

Table 1. Family business sample characteristics (N=4, year 2012)

Characteristics	Company code			
	A	B	C	D
Number of persons employed	40	186	27	15
Turnover	5 mln EUR	9 mln EUR	2 mln EUR	3 mln EUR
Business activity type	Manufacture Service	manufacture	manufacture	trade service
Law form	Limited liability partnership	Limited liability partnership	Sole-trader	General partner- ship
Income tax type	CIT	CIT	PIT	PIT
VAT payer	Yes	yes	Yes	Yes
Family owner- ship	100%	100%	100%	100%

Source: own research.

Three of the companies run manufacturing business (as a leading one), and one on trade-service activity (table 1). In their legal form, two represented limited liability partnership, one sole-trader, and one general partnership. A and B were Corporate Income Tax payers (CIT), which was imposed by their organizational structure, while C and D were Personal Income Tax payers (PIT). All of them was family members controlled in 100%.

Understanding what influences tax risk at business behavior in the context of intercultural management

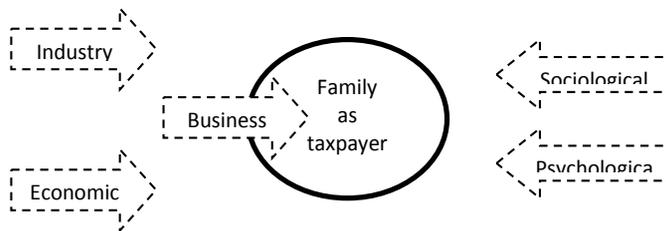
Financial performance and risk-taking proclivity affect company's goal setting and future performance expectations, especially in the context of the family business. Drawing from the behavioural theory of the company, it was argued that owners-managers of family companies upgrade their future performance expectations [Mahto, Khanin 2014, pp. 35]. Family companies may exhibit heterogeneity in their risk orientation so that greater tax risk taking will be positively associated with future performance expectations [Czemieli-Grzybowska 2013, s. 12].

System of public burdens forces the necessity of bearing expenses and adjustment to the external environment (*tax compliance*). It exposes companies for tax risk. A special type of business risk is connected with both the occurrence of specific sanctions and non-optimal management of expenses. The nature of tax risk is the lack of certainty about tax consequences of already realized, current or future economic operations [Poszwa 2007, p. 11]. Elements, which affect the tax risk from the point of view of entrepreneur, can be divided into few groups. Tax risk is usually identified with macroeconomic risk, risk of entrepreneur/taxpayer connected with change of amounts of taxes, choice of form of taxation, also risk of tax ex-

tent, tax construction, formal and material aspects [Raskolnikov 2008, pp. 154-170, Mozydlowski 2012, pp. 193-203]. Referring to the enumerated indicators of tax risk, its potential sources can be indicated. Furman [2012, p. 212] classifies sources of tax risk as external and internal sources. Entrepreneurs have practically no influence on external sources. But through proper tax risk management, they can have influence on internal factors. Stability of tax law favours the minimization of external risk but changeability makes running business more difficult and does not encourage to invest and develop. Degree of law complexity increase exhibition for tax risk, what often exposes companies to the risk of different or incorrect interpretation.

Analyzing the needs identified as the most important by the companies, it was found those related to profitability and costs were the most acute, as well as those related with production processes and consolidation of commercial networks [Bednarek, Buczacki, Guzmán, 2014, pp. 99]. Different factors that go together have influence the attitudes and behaviors of small businesses. Webley and Paul [2004, pp. 65] offer a model for those factors. The model allows to categorize the factors in a consistent manner and sufficiently robust to stand up to applied and practical application in a tax administration environment. This model shown in figure 1 is an approach based on the understanding of the business and the context within which it operates, as an aid to understanding the behavioral motivation towards taxation compliance.

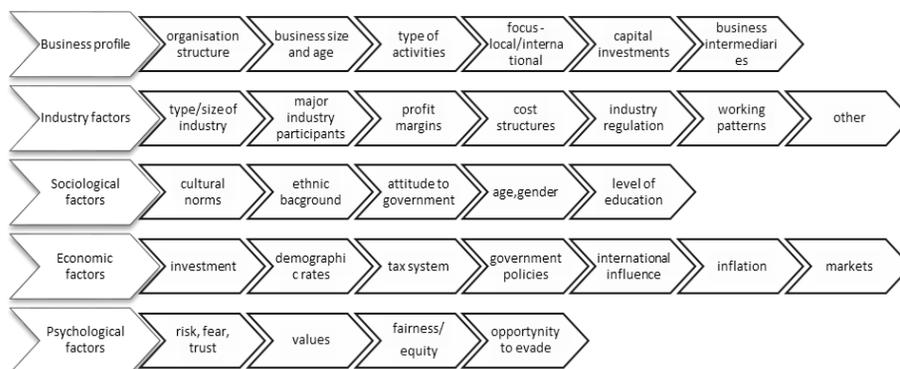
Figure 1. The model of business environment influence factors



Source: OECD 2004, p. 39.

The model represents 5 categories of different views of taxpaying entity. It offer a means to determine behavioral drivers of compliance treatment strategies. There is not easy to answer to what influences taxpayer behaviour. Research undertaken by Braithwaite [2002, pp. 15-30] suggests that the factors identified cause business taxpayers to adopt sets of values, beliefs and attitudes that can be described as *motivational postures*. These postures characterize the way company relates to a revenue authority and the tax system it administers. Understanding the factors that drive specific compliance behaviour is essential to guide the selection of appropriate treatment strategies.

Figure 2. Tax risk among total factors of business risk influencing the compliance behaviour of business



Source: OECD 2004.

As it is shown at the figure 2, external tax risk which is created by tax system is an economic factor that have impact on family-owned business. But tax risk is generated also internally at company. To discover which external and internal factors have impact on family businesses we ask some questions about to our respondents. Results are shown in the table 2.

Table 2. Sources of tax risk at companies

External	Company code	Factor	Internal	Company code	Factor
Un unstable tax law	A,B,C,D	Tax system	Internal procedures	B,C	Organisational structure
Country level tax policy	B,C,D	Tax system	Tax knowledge and awareness	D	Business size and age
Changeable tax regulations' interpretations	A,B,C,D	Tax system	Taxation form choice	D	Type of activities
Market conditions	A,B,C,D	Tax system	IT tools	C,D	Business intermediaries
			Professional tax optimization	B,C,D	All business

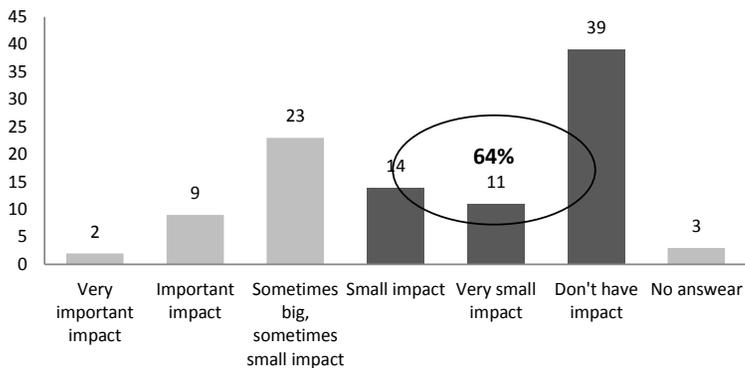
Source: own research.

The external risk in changeable interpretation of regulations, particularly VAT and social insurances, in the instability of regulations and in changes of market conditions. As an internal source of risk are specified the lack of (companies B, C and D) or defective internal tax procedures (B, C) and lack of professional tax optimization of concluded transactions and issues connected with succession (compa-

nies B, C and D). Company D finds sources of risk in the form of taxation, because together with the growth of company also increases the degree of complexity and accuracy of the record. It exposes a company to a risk connected with the possibility of making accounting and financial errors. Deficiency of knowledge concerning taxes, necessity of trainings and constant education, mainly among employees of the company were also noticed in this company. Deficiency of knowledge, or ignorance of the regulations among people who manage company is the main factor exhibiting family companies to a tax risk.

Style of management and reluctance of the owners of companies to employ on key position employees outside their families are also sources of tax risk. In Poland, according to the data of PARP [2008, pp. 56]. As many as 64% employees of family companies do not take part in making decisions or their participation is insignificant (figure 3).

Figure 3. The impact of non-family employees on decision making at the company (%)



Source: PARP 2008.

Table 3 shows, that only company B employs full-time accountants (3 persons) and uses the services of tax counsellor. Company A commissioned to the accounting office, all accounting and personnel obligations, but does not use the legal service and tax counselling. All accounting obligations in the company C are made by the owner's wife, and personnel issues by her daughter. Issues connected with concluding business agreements are commissioned to the legal office. Company does not use the services of tax counselling. Both accountancy and personnel are conducted by the owner's wife in the company D. Decisions concerning tax optimization and planning are also made by her.

Table 3. Tax service providers at family business and risk rating

Service	Company code							
	A	Risk rating	B	Risk rating	C	Risk rating	D	Risk rating
Accounting	Tax office	Low	Employed accountant	Low/moderate	Owner's wife	Significant	Owner's wife	Significant
Payroll	Tax office	Low	Employed accountant	Low/moderate	Owner's daughter	Significant	Owner's wife	Significant
Law counselling	-		-		Law office	Low	-	
Tax counselling	-		Professional tax advisor	Low	-		Owner's wife	High

Risk rating base on OECD method [2004, p. 29]: *severe* – other position, *high* – executive position, *significant* – senior position, *moderate* – middle position, *low* – routine position.

Source: own research.

Researched entrepreneurs confirm that small entrepreneurs rather do not use the services of law companies or tax counselling in the tax aspect of preparing trade contracts. The main reason are costs of these services. Among the companies being researched (A, B, C, D), tax and personnel activities were made by the very owners (or family members). Together with the growth of number of trade partners, concluded transactions and employment, companies A and B use the services of specialists. Small companies usually do not hire employees, who apart from filling out tax documentation would analyse tax changes or examine concluded agreements from the tax point of view. Many entrepreneurs are not aware of the consequences of made and detected mistakes in tax settlements.

Ideal patterns of tax risk minimization would be a system of management that inform who in the organization is responsible for dealing with the risk (table 3). This involve close and detailed connection with government representatives and perhaps other agencies as well. As the severity of the compliance risk exposure decreases the organizational level at which the risk can be appropriately managed and reduced. Risk assessment and prioritization will be repeated at several levels of the organization. If the organization's strategic risks have been identified it will allow further refine the broad strategic risks and to determine priority areas. Once these decisions and priorities have been assigned, operational line management can begin the process of identifying specific cases from within their area of influence for further action. The extent of the risk being managed is progressively reduced and managed at an appropriate level within the organization.

Tax risk consequences for the management at family businesses

There is a clear division into employees from the family and those who are outside. Owner has greater trust in family members, and they are better motivated, flexible and able to sacrifice in the aim a company. In company D, almost all of the key positions are occupied by the family members. On the other hand, it makes access to specialized employees more difficult and make strategy of this company dependent on the family. Employing family members on the executive positions is understandable and not always a bad choice. It sometimes happens that belonging to the family or loyalty will compensate the lack of knowledge and experience. However, it should be remembered that the tax risk is significantly reduced with appropriate optimization in proper execution, based on the knowledge, and not only blood ties.

Tax risk can also be considered from the point of view of legal and business effect of tax compliance for the entrepreneur [Poszwa 2007, p. 13]. Effects of difficulties in tax risk management can be: risk of tax surcharge, financial sanction, loss of benefits resulting from tax optimization, risk of loss of reputation, risk of double taxation, risk of loss of financial liquidity, or decrease of profitability and competitiveness. Therefore, such consequences are preceded with initial phase, mainly demand of explanation or tax control. An issue of frequency and scope of these events was discussed during interview. In table 4 there are information about problems connected with the controls in a company, their scope and effects in a form of tax and penal and fiscal proceedings.

Table 4. Official tax procedures in last 5 years of business activity (2008-2012)

<i>Type of procedure</i>	<i>Company code</i>			
	<i>A</i>	<i>B</i>	<i>C</i>	<i>D</i>
Number of controls	14	1	6	17
Scopes of control (number)	VAT (4)	Labour law (1)	VAT (5) cross-check (1)	PIT (1) VAT (16)
Number of tax proceedings	0	0	1	1
Number of penal and fiscal proceedings	0	0	0	0
<i>Type of risk</i>	<i>A</i>	<i>B</i>	<i>C</i>	<i>D</i>
Registration	+	-	+	+
Filing	-	-	+	+
Reporting	-	-	+	+
Payment	+	+	+	+

+ exposure for risk took place, - exposure for risk didn't take place

Source: own research.

Effects of risk management lackness can be severe for the family companies. High risk, when it comes to taxes, brings about VAT because this a tax that is most often verified. Companies A and D were controlled every time because there was a return of VAT to the bank account. For that reason, company C was controlled five times. There were controls in the companies B and C by way of labour law and cross-check. As a result of checking activities, tax proceedings in the companies C and D were instituted, and then discontinued. None of these companies had a penal and fiscal proceedings. During an interview with the owner of company D, it was noticed that there was once in the history of activity (2005), a bank account attachment by way of tax arrears. Each company, in the researched period was three times summoned to Tax Office in order to explain an issue or a problem. During interviews it was noticed that sometimes companies are exposure on risk during different activities undertaking by business owners. Company A was exposed to risk during registration and also have some troubles with tax payments (also B). Companies C and D was exposed during registration, filing forms, reporting and payment.

Shaping internal factors of tax risk lies on entrepreneur who should take actions leading to reduction of this factor of business environment. It can be done by formulation of assumptions of tax strategy, understood as actions taken which enable tax optimization [Wilimowska, Urbańska 2009, p. 144]. It would be profitable if strategy was implemented in a moment of beginning of activity, when it concerns a form of taxation, and then in the period of activity [Walczak 2009, p. 241, Walicka 2014, p. 371-382]. Important issue is also to employ specialists, or to use the services of specialists. Small companies are usually able to settle themselves (owner or a family keep records). However, the time and necessity of compliance often makes long-term planning of tax strategies leading towards risk minimization and amount of tax obligation impossible. That is why the entrepreneur should take into consideration a moment, when should make a decision of using the services of professional counselling, or about employing qualified employee.

Optimal combination of elements presented in table 5 should be one of the areas of company's strategic decisions. Because to a large extent, it decides about financial condition and even market position. However, it requires modification of style of family business management and appropriate qualifications of the employees that make decisions. Employing family members on executive positions is understandable and is not always a bad solution. It often leads to a situation when risk management boils down only to informal discussion among family members. Incompetent application of tax optimization can expose a company to a huge risk, and in consequence even to bankruptcy.

Table 5. Procedures and strategies of action in management of tax risk in family company

INTERNAL RISK MANAGEMENT	Procedures concerning:	Strategies concerning:		
	Organizational and legal form	Legal personality	Capital groups	Structures of employment
	Choice of the place of activity	Tax heavens		
	Costs	Strategies of disbursements' valuation	Depreciation	High costs
	Preferences and tax exemptions	Donation	Activity B+R	CBR status
	Choice of the subject of activity	Activity profile change	Change of the scope of activity	
	Company's economy	Political strategies		

Source: own research.

Conclusion

It should be noted that above legal consequences of the lack of tax management can have business consequences. In the company D, it was stated that due to the frequent controls, family's reputation decreased in the eyes of employees. In the company C, it was stated that tax proceedings caused conflicts in the company and threatened its image. In the researched companies, tax risk did not cause too big disturbances in the running of a business. Possible worse scenarios could be the loss of financial liquidity (e.g. through bank account attachment by the Tax Office) or loss of property as a result of enforcement, and in consequence lead to bankruptcy.

Violation of the rules can have serious financial consequences. It does not matter whether managed business will do it consciously or not. The consequences of under-reporting obligations or improper tax strategy could affect the competitive position of the company, undermining trust in the family.

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