KPMG

cutting through complexity

TAX

Good, Better, Best

Financial Services

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Introduction

For the KPMG network, a top priority is helping member firm clients manage tax transformation and position their businesses for future success. Since 2006, we have conducted regular surveys of tax executives around the globe to uncover their most pressing issues. Our purpose is to gain insights on how these issues influence changes in structure, investments in people and processes, and overall objectives and priorities.

Now, in this updated survey conducted in late 2012, the environment in which tax directors operate has changed dramatically. Lingering economic uncertainty is increasing pressure on companies to cut costs and on tax authorities to boost revenue. Globalization continues to spur centralization of finance, tax and other functions. Companies are expected to improve their governance, accountability and transparency in all areas. Further, political attitudes toward taxation are shifting, with much more focus on civic responsibility and public demands that companies should pay their "fair share" of tax to the jurisdictions where they earn profits.

With this environment as a backdrop, we sought to identify trends and benchmarks on the following fundamental questions:

- How are tax departments changing their operations to address emerging economic, business and regulatory trends?
- How are they progressing on aspects of governance and performance such as strategy, risk management and measurement?
- How are they approaching process and technology investment and improvement, including the impact of cloud computing?
- How are they addressing the pressure to more effectively resource how they do their work?
- How are they responding to rising tax authority scrutiny and demands?

The survey now shows that tax departments have made good progress in several of these key areas. However, in a rapidly changing business and regulatory environment, the results also suggest that there is still work to do if tax departments are to meet the dual challenges of effectively managing risk while providing more effective, real-time support to business activity and influence on the bottom line.

Focus on Financial Services

Increasing regulation, new tax requirements, rising tax audit demands and heightened reputational risk – KPMG International's survey of tax executives shows that tax departments of multinational companies in the Financial Services (FS) industry face a formidable range of external threats. Internally, evolving business models and intensifying cost pressure present equally difficult management challenges.

How can FS tax directors deploy their time and resources to meet these demands and go beyond to support business activity and improve the bottom line? The survey reinforces KPMG's view that FS companies can derive more value from their tax departments by focusing on the following imperatives.

- **Embed boardroom behavior in the tax department.** FS tax departments are attracting more guidance and support from boards and corporate leadership in the development of tax department strategies that align with the company's overall business strategy. But as tax-related financial and reputational costs continue to mount, tax directors need to take a board director's mindset, zeroing in on game-changing tax issues, like financial transaction taxes, and bringing them to the board with plans for action.

- **Adopt a holistic approach to tax management.** While tax compliance is critical, tax departments need to connect with all parts of the business to ensure tax considerations are integral to daily operations and major business decisions. This requires sound procedures and controls not only for tax reporting and operational taxes (like VAT, stamp duties and withholding taxes) but also for broader initiatives like group restructurings and the development of new products and business lines.

KPMG's series of benchmarking studies of tax department structures and operations shows that leading tax departments – those that add the most value to their businesses – do so by putting high priority on three areas:

1. ensuring clarity of accountabilities
2. driving standardization and efficiency
3. promoting connectivity with their colleagues across the business through a proactive, outward-reaching tax department.

In conducting the survey in late 2012 on behalf of KPMG's member firms, we were keen to see how tax departments have progressed in these areas, especially given ongoing economic uncertainty and continuing regulatory reform.

This report highlights insights on how tax departments of companies in the FS industry have advanced since our last survey in 2009. For analysis of the global survey results, visit kpmg.com/goodbetterbest.

- **Embrace global standardization of tax department roles, processes and controls.** With the diverse range of tax obligations across FS companies' operations and the challenges of managing sweeping regulatory change, global consistency and control are essential. Standardization streamlines routine tasks, increases accuracy, facilitates technology use and promotes better understanding and communication of tax matters across the company.
- **Work smarter.** FS tax departments can leverage existing resources more effectively by investing in process improvements and technology and by making strategic use of outsourcing, co-sourcing and shared service centers to carry out or support tax department activities. Doing so can help tax departments to keep up with rising regulatory and tax audit demands while freeing more of their time to engage in strategic pursuits that influence the bottom line.

Clarifying of accountabilities – heavy regulation puts tax in the spotlight

Following the 2008 financial crisis, FS companies have faced a wave of regulation, and risk, control, and transparency have become top priorities. As governments set new rules to guard against a future financial crisis and promote financial and environmental stewardship, today's FS companies face ever more demands to improve the strength of their systems, processes, and governance.

Taxation of FS companies and their customers is a key focus of governments and regulators. Among other things, tax departments of banks, insurers and investment funds are under intense pressure to keep up with the swift pace of regulatory change from:

- the introduction of new financial transactions taxes in several European countries
- the US Foreign Account Tax Compliance Act
- the European Union's country-by-country tax reporting rules
- codes of tax conduct based on model published by the Organisation for Economic Cooperation and Development (OECD).

Attitudes toward tax are shifting – and reputational risk is rising – as governments and the public call on financial institutions and other large corporations to pay a "fair share" of tax to the countries from which they earn their profits.

In this context, it is not surprising the tax governance has risen in priority for boards and corporate leadership of FS companies. As part of such oversight, previous KPMG tax department benchmarking studies have shown that leading tax departments put priority on ensuring tax department's roles and responsibilities are clear and commonly understood within the context of a company-wide, board-approved tax governance framework.

Currently, virtually all FS respondents say their company has a tax department strategy that is consistent with the company's overall business strategy. For 75 percent of respondents, the board and/or corporate leadership are directly involved in providing guidance on the tax strategy. Similarly, 77 percent of respondents report that their board has approved the tax strategy.

For tax departments, rising board-level attention to tax can be beneficial. But despite recent progress, tax directors could still do more to engage with boards and upper management on business-critical tax issues. Tax directors need to embed a boardroom mindset into their roles by proactively advising boards and upper management on the commercial risks and opportunities arising from tax developments that could profoundly affect the FS company's business. Along with the FATCA rules and new financial transaction taxes discussed earlier, the United Kingdom's new procurement regime – which requires consideration of tax contributions and behavior in awarding government contracts – is another game-changing example that tax directors should escalate to their boards for collaborative action.

97%
of FS respondents have a tax department strategy that aligns with their overall business strategy

75%
say their board or corporate leadership provided direct guidance on the strategy's development

Further, while tax compliance is a critical component of the tax department's role, there is a risk that the prioritization of compliance over other, more strategic pursuits can diminish the tax department's contribution to the company's value. And with FS respondents reporting more tax audit and controversy activity worldwide, tax departments could have even less time and resources to spare for activities beyond compliance.

60%
of FS tax departments are involved in some form of tax controversy

Survey results suggest that FS tax departments' primary focus is on day-to-day compliance work. FS respondents say that accurate and timely tax return compliance is the most important activity driving tax department objectives, followed closely by accurate and timely financial reporting and managing tax risk. These are the most likely activities to have KPIs assigned to benchmark and measure tax department performance.

Further, 60 percent of FS respondents say they are involved in some form of tax controversy. For example:

- 33 percent of FS respondents say they are currently involved in corporate income tax controversy
- 32 percent are involved in indirect tax (sales/use or VAT/GST) controversy
- 23 percent are involved in disputes involving local (state) income tax
- 22 percent are involved in disputes involving transfer pricing.

In the future, tax controversy may rise even higher. FS respondents report that the tax authorities are becoming more focused on auditing not only corporate income and indirect taxes but also tax and accounting processes and controls.

Driving efficiency – tax process & control improvements

Another aspect of good tax governance is establishing a tax department structure that aligns to the company-wide strategy and includes clear reporting lines and accountabilities. To improve accountability, control and standardized approaches, most FS companies have centralized the management and structure of resources in global or business-wide headquarters tax departments. Currently, 80 percent of FS respondents say that their global tax function is directed, managed or coordinated from a headquarters tax department.

69%
of FS respondents have global standards related to tax policies and procedures

Additionally, 56 percent have employees with tax responsibilities for particular regions or multiple countries, 58 percent have employees responsible for single countries, and 55 percent have employees with responsibilities for business units or divisions.

80%
have a headquarters tax department that directs, manages or coordinates global tax department activities

Our previous research identified a focus on standardization and efficiency as a key characteristic of leading tax departments. Standardization eases the management of complex data flows, streamlines the performance of routine tasks and increases the accuracy of tax data and related filings. It facilitates the use of technology to monitor results and investigate anomalies. It also helps foster better understanding and communication of tax matters across the company.

Survey results show that tax departments of FS companies are actively working to make their global tax processes and controls more uniform. The majority of FS respondents rate the levels of standardization of their tax controls, policies and procedures as "standardized" or "very standardized"– but these ratings are lower than those of other industries.

Responsibilities and accountabilities of tax personnel are the most standardized areas for FS respondents, followed by controls and learning, development and career paths for tax personnel. FS respondents report higher-than-average levels of standardization for their tax return and annual tax provisions processes, but lower-than-average levels for other tax compliance activities in the annual cycle such as forecasts of tax expense or tax rates and reconciliation of annual provisions and returns.

A few factors may be contributing to the relatively lower standardization of FS tax department activities and deliverables. FS tax departments need to manage a highly diverse range of tax obligations, including corporate income, value added taxes withholding taxes, stamp duties and industry-specific requirements. They also provide support both for back-office tax compliance work and for front office transactions and products. The diverse range of activities makes standardization across the global tax department more difficult to achieve.

Further, due to the extensive regulatory changes for the industry that followed the financial crisis, the roles and responsibilities of tax departments and broader finance functions have thoroughly transformed. Standardization may have been neglected in the struggle to keep up.

This may be set to change. The majority of FS tax departments are making investments in improving their tax and finance function processes and controls. For example, 66 percent are providing better training for existing staff, 65 percent are conducting or plan to conduct overall tax strategy and operational reviews, and 60 percent have process-related improvements in the works.

Compared to companies in other industries, harnessing additional tax technology and process improvements is higher on the agenda for most FS respondents. Fewer FS respondents say that the level of investment in technology and tax process improvement in their tax department is "about right" – 70 percent, compared to 75 percent of respondents in other industries.

FS respondents are less likely than their peers in other industries to use outsourcing, co-sourcing and shared service centers to carry out or support tax department activities. As a result, FS companies may be missing opportunities to use outsourcing strategically to free up in-house resources for other activities and to access best practices and investments in people, processes and technology that cannot be developed in-house.

Currently, 31 percent of FS respondents use outsourcing for this purpose, compared with 35 percent of other industries; 30 percent use a finance or accounting shared service center to support the tax department (30 percent in other industries), and 27 percent rely on other finance resources (25 percent in other industries).

Corporate income tax compliance and tax controversy support are the most outsourced tax activities among FS companies, followed by tax planning and business support. Improved management and visibility over compliance activities is considered as the most important characteristic guiding decisions over what FS tax department activities to outsource, followed by head count/costs reductions and access to compliance technologies.

Promoting connectivity – compliance focus takes precedence

As in other industries, tax departments of FS companies put more emphasis on compliance-related activities than they do on improving interaction with other parts of the business. While compliance is crucial, KPMG International's research shows that connectivity is important for tax departments to achieve their full potential as contributors to business strategy and drivers of value. Connectivity is especially important for tax departments of FS companies, given the higher level of tax support needed for front-office functions, for example, in the development and delivery of new products and services.

In the next 12 months, FS respondents expect financial reporting and tax return compliance to occupy 21 percent and 18 percent of tax department time respectively. Managing tax authority audits is expected to occupy 11 percent of tax department time.

However, only 8 percent of tax department time is expected to be spent on integration with business groups and early indication of non-routine transactions. Other strategic activities of optimizing the effective tax rate and cash tax planning/tax deferral are only allocated 11 and 10 percent respectively.

In light of rising tax audit scrutiny and controversy in most markets, it seems likely that FS tax departments will have to devote even more time to compliance and managing tax audits in the future than they do now. As a result, they could soon have even less time and resources to devote to more strategic pursuits.

While FS tax departments are working to enhance their processes and controls, there is less appetite for more fundamental structural improvements. For example, 79 percent of FS respondents believe their administrative budget is sufficient, and only 17 percent expect their tax department structure to change in the near future.

However, it appears that some forward-thinking FS companies recognize the importance of improving their tax department's connectivity with the broader business. Of the minority of respondents that do expect to restructure, alignment of the tax department with the business or finance function is the most common reason given, named by 62 percent of respondents.

Given the importance of tax involvement in both front and back office activities of FS companies, the current lack of emphasis on connectivity is unexpected. Looking ahead, it seems likely that efforts to improve collaboration could be pushed further aside as regulation, tax complexity and pressure to reduce costs continues to mount. As a result, FS tax departments will be more constrained in their ability to provide effective, real-time support to business activity and influence the bottom line.

By investing in additional standardization, process improvement and tax technology, FS companies will be better able to boost efficiency and keep up with their compliance demands, while improving the ability of their tax teams to collaborate with the peers in other departments and add greater value.

50%
of FS tax departments' time is expected to be spent on tax compliance, reporting, managing tax audits and managing tax risk in next 12 months

29%
of time would be spent on integrating with the business, optimizing the effective tax rate and cash tax planning/deferral

79%
of FS respondents say their administrative budget is sufficient

17%
expect their tax department to be restructured in the near future

62%
of these restructurings would aim to better align the tax department with the business

Blueprint for change

As tax departments struggle to cope with mounting regulatory and cost pressures, leading organizations are seeing that a transformational approach can show the way forward. KPMG International's research has distilled the following steps as crucial elements in a tax department's blueprint for change.

1. Establish a **common purpose** by aligning strategic goals and objectives of the tax department with those of the wider company.
2. Define **one view of performance** to monitor effective tax management by clarifying requirements and how performance is measured and valued, through agreed-upon KPIs.
3. Ensure the tax department has **high-performing teams** with the right number of tax professionals and the right mix of training, skills and experience.
4. **Embed processes** to realize the tax management strategy in a way that is measurable and sustainable for the long-term.
5. Set systems and procedures to produce, exchange, and distribute **timely and accurate information** to the right people, at the right time, and in the right format.
6. Employ **enabling technologies** (e.g. enterprise resource planning systems, tax software) to automate labor-intensive processes that consume resources and increase risk.
7. **Influence stakeholders** by understanding their goals and constraints and communicating with them to help achieve the goals.
8. Set processes and priorities and align the tax department's structure to promote **connectivity and collaboration** between tax teams and other departments.

About the survey

- KPMG International's global survey of people in charge of tax policy and operations of businesses worldwide is one of the largest surveys of its kind.
- Iterations of the survey have been conducted regularly since 2006, charting the evolution of leading tax departments and identifying operational benchmarks for high-performing tax teams.
- For the 2012 survey, 1,150 heads of tax in 22 countries, including 177 respondents in FS companies, took part in blind telephone surveys to share their opinions on how tax departments are adapting to current business challenges. About 700 of respondent companies are Fortune 500, Forbes 2000 or equivalent companies.
- To gain more clarity on the telephone survey results, additional in-depth interviews were conducted with several clients of KPMG member firms and tax professionals worldwide.

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