KPMG

cutting through complexity

TAX

# Good, Better, Best

Hong Kong

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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. Globalisation continues to spur centralisation 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 Hong Kong

**Based on KPMG International's survey of tax executives, tax departments of Hong multinational companies based in Hong Kong are:**

- **putting higher priority on financial reporting and tax compliance work than on other, more value-adding activities,** compared to their global peers
- **centralising their activities within headquarters tax departments at a rapid rate,** possibly due to Hong Kong's growing popularity as a headquarters location for companies serving China and other Asia-Pacific countries
- **likely to be perceived as cost centres,** focused primarily on compliance, rather than as value-driving business partners to the wider business
- **making progress on standardising tax department and tax compliance processes,** as a result of changing priorities of the finance function
- **unlikely to improve their ability to provide effective, real-time support to business units** and elevate their status within the company, unless they take greater steps to improve the department's efficiency and ability to contribute value.

KPMG's series of benchmarking surveys of tax department structures and operations has shown 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 standardisation and efficiency
3. promoting connectivity with their colleagues across the business through a proactive, outward-reaching tax department.

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

This report highlights insights from the survey on how Hong Kong tax departments have advanced since our last survey in 2009. For analysis of the global survey results, read *Good Better Best 2012,* and visit kpmg.com/goodbetterbest for more country reports, industry-related data, interactive tools and more.

## Clarifying of accountabilities – increased use of tax strategies

Currently, the percentage of Hong-Kong-based respondents who report having a tax strategy that is consistent with their overall business strategy rose to 92 percent, from 57 percent in 2009. The number of respondents who say their board has approved the strategy rose to 88 percent, from 50 percent in 2009, and 74 percent of respondents say their board or corporate leadership had guided the strategy's development.

However, only 56 percent of respondents had formally documented the strategy, and only 60 percent had documented their approach to tax risk management. Documentation is important to ensuring the strategy or approach is clearly communicated and consistently followed.

Compared to their global counterparts, Hong Kong-based tax departments put higher priority on financial reporting and tax compliance work than on other activities. In terms of performance measurement, 90 percent of Hong Kong-based tax departments have developed key performance indicators (KPI) for accurate/timely financial reporting, compared to 80 percent globally, and 84 percent have KPIs for accurate/timely tax return compliance, compared to 76 percent globally.

Despite the relatively higher priority on compliance and reporting in terms of KPIs, Hong Kong-based respondents expect to spend less time on these activities than tax departments in other countries. When asked where their tax department would devote its time over the next 12 months, Hong Kong-based respondents expect to spend 14 percent of their time on financial reporting, compared to 20 percent globally, and 15 percent of their time on tax compliance, compared to 19 percent globally.

**92%**
of Hong Kong-based tax departments have a strategy that aligns with their overall business strategy

**56%**
have formally documented their tax strategy

**90%**
of Hong Kong-based tax departments have KPIs for accurate/timely financial reporting, compared to **80%** globally

The lower proportion of time devoted to these activities reflects the Hong Kong's relatively straightforward tax system, which has seen little change in recent years and does not impose any complex indirect taxes. However, the high emphasis on these activities suggests that Hong Kong-based companies expect tax departments to serve primarily as service providers to the finance function and that tax is primarily a cost to be managed, rather than a lever that can add value in the company. This finding is borne out further by the survey results from Hong Kong respondents in the areas of standardisation and connectivity.

**14%** of tax department time is expected to be spent on financial reporting, compared to **20%** globally

## Driving efficiency – standardisation driven by finance functions

Hong Kong-based tax departments have undergone rapid centralisation in the past three years. Currently, 92 percent of respondents say their company has a headquarters tax department that directs, manages and coordinates the global tax department, up from 47 percent in 2009. The result is in line with the global trend (76 percent report a headquarters tax department currently, up from 56 percent in 2009), but tax department centralisation appears to be occurring in Hong Kong among more companies and at a faster rate.

**92%** have a centralised headquarters tax department, up from **47%** in 2009

The rapid rate of centralisation may reflect Hong Kong's growing popularity as a location for regional headquarters companies doing business in China and other Asia-Pacific countries.

Despite increased centralisation, the levels of standardisation reported by Hong Kong respondents in the areas of tax controls, responsibilities and accountabilities of tax personnel, and policies and procedures were near or below those reported globally. However, levels of standardisation for tax compliance and return processes were slightly higher than those reported globally.

Again, the greater focus on standardising compliance and processes suggests that finance functions are dominating the tax department's agenda. Survey results indicate that the progress on standardisation and automation reported by Hong Kong-based tax departments has resulted from changing priorities of finance functions in the past few years, rather than of tax departments. The percentage of Hong Kong-based respondents who agreed that their company's finance leadership drives standardisation of the global tax department to some extent has increased significantly since 2009.

**48%** are engaged in or planning a tax strategy and operational review

Further improvement of tax department activities and processes does not appear to be a high priority. Only 30 percent of Hong Kong-based respondents say they have process-related improvement projects in progress, well below the global result of 61 percent for 2012. Only 50 percent say they are engaged in or plan to undertake an overall tax strategy and operational review, compared to 62 percent globally.

Hong Kong-based companies appear more likely to direct investment toward finance function improvements: 86 percent of Hong Kong-based respondents are undertaking finance function strategic reviews (compared to 61 percent globally).

**86%** are undertaking finance function strategic reviews

## Promoting connectivity – work to do in communicating value

Despite signs that Hong Kong-based tax departments may be interacting more with boards and upper management, there seems to be little desire to improve interaction with other parts of the business – which is crucial for tax departments to achieve their full potential as contributors to business strategy and drivers of value.

As noted, tax compliance and financial reporting activities take priority over value-adding activities. Integration with business groups and early indication of routine transactions rank low in priority in terms of how the tax department is measured. Given Hong Kong's relatively simple tax system, one would think tax departments have more time available than those based in other countries to spend on value-adding activities like cash tax planning, integration with business groups and early identification of non-routine activities. However, we expect that regional tax departments based in Hong Kong may also be required to spend time managing tax issues arising in the region.

Among Hong Kong-based companies, pressure to reduce costs has increased substantially. Even as they have become more centralised, Hong Kong-based tax departments have reduced their complement of tax professionals. According to respondents, overall full-time global head counts have dropped. Further, the number of respondents who say their tax department has employees responsible for particular regions or countries dropped to 61 percent currently (from 75 percent in 2009) and those with employees responsible for single countries dropped to 38 percent (from 60 percent).

Interestingly, Hong Kong-based respondents also were more likely than their global peers to report having employees with tax responsibilities for particular business units or divisions: 72 percent of respondents have employees who are responsible for business units, significantly higher than the global result of 55 percent. Over half of these employees report directly to the headquarters tax department, while 33 percent of them report to regional finance or accounting personnel.

Business unit tax employees appear more likely to have been retained than other tax staff over the past few years. This suggests that integration of these employees with the business allows them to be more hands-on and visible to their fellow employees in other business units, and more likely to be recognised for the value they contribute.

Overall, Hong Kong-based respondents appear satisfied with the existing status quo: 78 percent are satisfied with their current administrative budgets, 80 percent are satisfied with levels of investment in tax technology and process improvement, and only 6 percent expect the structure of their tax department to change in the near future.

For organisations seeking to derive the most value from their tax departments, this satisfaction appears to be misplaced. As pressure to cut costs continues, Hong Kong-based tax departments need to do a better job of reaching out to their colleagues across the business to provide effective, real-time support to business activity and influence the bottom line. Until the business case can be made to improve the department's efficiency and ability to drive value, Hong Kong-based tax departments will continue to receive less priority and investment than other parts of the business.

**78%**
are satisfied with current tax administration budgets

**6%**
expect their tax department to be restructured in the near future

## Blueprint for change

As tax departments struggle to cope with mounting regulatory and cost pressures, leading organisations 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 realise 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 labour-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 50 respondents from Hong Kong, took part in blind telephone surveys to share their opinions on how tax departments are adapting to current business challenges. About 700 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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