KPMG

cutting through complexity

TAX

Good, Better, Best

Italy

kpmg.com/goodbetterbest

Contents

Introduction

For the member firms of KPMG International, a top priority is helping our clients manage tax transformation and innovation to 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 Italy

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

- **less likely to say their company has a tax department strategy that aligns with their overall business strategy** than their counterparts elsewhere in Europe and Africa
- **expecting to see interaction between boards and tax departments increase in the coming years** due to new risk-based approach to tax audits and other initiatives of tax authorities in Italy and some other European countries
- **facing rising tax audit and controversy levels** as fiscally challenged governments in the region seek to increase tax revenues
- **working to improve the efficiency and effectiveness of their tax processes and controls,** although the levels of standardisation of their tax compliance processes remain below regional averages
- **likely to see corporate leaders take action to improve connectivity between tax and other departments,** in light of stepped-up tax audit and enforcement activity and the personal liability of CEOs for financial and criminal activity
- **expecting to benefit from increasing connectivity with the business,** as their tax teams have more opportunities to collaborate with other departments.

KPMG International's series of global benchmarking studies show that leading tax departments – those that add the most value to their businesses – do so by putting high priority on three areas:

1. Clarifying accountabilities
2. Driving standardisation and efficiency
3. Promoting connectivity with their colleagues across the business in support of a proactive tax department.

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

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

Clarifying accountabilities – board interest & interaction expected to increase

In the area of accountability, it is important to ensure that the tax department's strategic goals and objectives are aligned with those of the wider organisation. Compared to respondents from Europe and Africa ("the region"), respondents from Italy are less likely to say their company has a tax department strategy that aligns with their overall business strategy – 74 percent say they have such a strategy, compared to 93 percent of respondents from the region.

74%
of Italy-based respondents have a strategy that aligns with their overall business strategy

Respondents from Italy also report a lower degree of interest and interaction between boards, upper management and tax departments in developing the company's tax strategy. Only 50 percent of respondents in Italy say their tax strategy has board-level approval, compared to 70 percent regionally, and only 40 percent say the board and/or corporate leadership are directly involved in providing guidance on the tax strategy, compared to 40 percent regionally.

Only 1/2
of these department strategies are board-approved

In the near future, Italy-based companies with regional or international operations are expected to rapidly catch up to their peers in terms of board-level involvement in tax department strategy and oversight. In the past, boards have taken interest in tax matters only where large transactions or significant controversy has been involved. Going forward, it appears likely that Italy's new government will proceed with plans to adopt a risk-based approach to tax audits, similar to those in place in the United Kingdom and other European countries. Under this approach, the tax authority will base the extent of its audit scrutiny of large tax filers on its evaluation of the strength of the company's tax governance policies and controls. Additionally, the Bank of Italy and the Italian Stock Exchange Commission have expressed interest in the quality of tax risk management and oversight in larger companies. Such developments in Italy and across the region are already beginning to compel Italian directors and corporate leaders of regional and international companies to ensure greater attention is paid to tax matters, for example, by appointing dedicated tax risk officers.

Additionally, companies based in Italy will need to respond to heightened tax audit and controversy activity, which has increased markedly since 2009. Governments throughout the financially troubled region are stepping up their audit activity in order to increase tax revenues. Reported levels of disputes from Italian respondents have risen sharply in the past three years in many taxation areas as a result.

Currently, 94 percent of respondents in Italy say they are involved in some form of tax controversy. For example, 48 percent of respondents from Italy are involved in federal (national) corporate income tax controversy, up from 30 percent in 2009, and 48 percent are involved in local (state) income tax controversy, up from 17 percent in 2009. Due to the Italian tax authority's focus on transfer pricing and business restructurings in particular, 40 percent of respondents are involved in transfer pricing disputes, up from 0 percent in 2009.

As governments in Europe work ever harder to improve their finances, tax audit risk and controversy is expected to rise even higher. Boards and upper management of Italian global companies will need to give higher priority to the governance and management of tax in their organisations as a result.

94%
of Italian-based companies are involved in some form of tax controversy

48%
are involved in federal or state (local) income tax controversy

40%
are involved in transfer pricing disputes

Driving efficiency – high focus on standardisation and process improvement

While there is room for improvement in the area of accountability and oversight, Italian companies are making better progress with their efforts to improve the efficiency and accuracy of their tax department controls and processes. For example, 74 percent of them have process-related projects in progress or under consideration for their tax departments (compared to 66 percent regionally); 68 percent are undertaking technology related improvements (also 59 percent regionally); and 58 percent are providing better training to their existing staff (63 percent regionally).

However, companies based in Italy are less likely to report finance function transformation initiatives, for example, in undertaking process improvements (56 percent versus 70 percent globally) and risk management and/or controls improvements (46 percent versus 74 percent regionally). The only area where respondents from Italy are slightly more likely to report finance initiatives are those of technology improvement (60 percent, compared to 58 percent regionally) and the implementation of shared service centres (36 percent, compared to 33 percent regionally).

Respondents in Italy report lower levels of standardisation of their global tax departments and activities than their peers in the region. The most standardised areas of global tax department for Italian companies are in learning, development and career path for tax personnel, tax staff accountabilities and tax controls. In terms of the annual tax compliance cycle (from forecasting through financial reporting, filing of returns and reconciliation), reported standardisation is also below regional averages.

Perhaps due to pressure to reduce costs, tax departments in Italy appear to be less strategic in their sourcing practices than those based in other countries. Currently, only 26 percent of respondents in Italy say they use outsourcing or co-sourcing to carry out or

26%
of respondents in Italy use outsourcing or co-sourcing to carry out or support their tax department activities

support tax department responsibilities, compared to 38 percent regionally. Further, only 2 percent of respondents in Italy say they use a finance or accounting shared service centre to support the tax department, and only 2 percent use finance or accounting share service centres for this purpose.

2%
use shared service centres and/or other finance resources

The one-quarter of respondents in Italy that do outsource or co-source tax department activities has reduced their use of third party service providers in most areas. The only area where usage increased was in the area of tax planning and business support.

Overall, these results suggest that companies in Italy have yet to recognise the benefits of using sourcing strategically to access tax resources with highly specialised and/or local knowledge when a business need arises. Doing so would allow them to efficiently manage compliance in the jurisdictions in which they do business while allowing their in-house tax teams to focus on other, more value-adding pursuits.

Promoting connectivity – penalties for non-compliance force more integration

Survey results show that tax departments in Italy and across Europe are highly focused on compliance and reporting activities, while other, more value-adding activities, such as integration with the business, are lower in priority. Without strong connectivity between the tax department and other departments, tax teams will be limited in their ability to collaborate as proactive business partners in setting and advancing business objectives and contributing value to the company.

61%
of tax department time will be spent on tax compliance, financial reporting and managing tax audits

When asked where they expect their tax department would devote its time over the next 12 months, respondents in Italy gave the highest rankings to tax compliance and financial reporting. Given Italy's current tax audit environment, it is perhaps not surprising that these activities are expected to occupy 27 percent and 24 percent of tax department time respectively, while managing tax audits is expected to take up 10 percent. However, these results are still significantly higher than responses from other countries in the region.

31%
of time will be spent on integration with the business, optimising ETR and cash tax savings/tax deferral

In contrast, integration with business groups and early indication of non-routine transactions is expected to occupy only 5 percent of tax department time. Other value-adding pursuits are also allotted less time in the coming year: only 14 percent of tax department time will be spent on optimising the effective tax rate (ETR) and 12 percent will be spent on cash tax savings and tax deferrals.

Only 10%
of tax departments in Italy will be restructured in the near future

In the short term, however, most tax departments in Italy do not appear likely to undergo significant change. Only 10 percent of respondents in Italy expect changes in the structure of their tax department. Of these companies, improving risk management (100 percent), improving controls (80 percent) and reducing costs are most commonly named as being among the primary reasons for the change. Better alignment with the business and/or finance function structure and/or improving efficiencies are among the least popular reasons.

At the same time, as Italy's tax authority grows more aggressive in its tax audit practices, its inspectors are more likely to apply financial or criminal penalties against CEOs, who are

required to sign Italian tax returns. As with the expected increase in the involvement of boards discussed above, CEOs' personal liability for tax compliance could compel greater integration between tax departments and other parts of the business. This threat could cause corporate leaders to take action to ensure, for example, that various departments cooperate to ensure the company's transfer prices are defensible and well documented and work together to local income and indirect tax compliance needs are met in every location where the company has operations.

Given the challenges ahead, global companies based in Italy should reconsider whether their tax departments are well equipped to balance managing tax risk, ensuring compliance and creating value by providing the necessary resources in order to cover the fiscal requirements, in line with the company's global strategy. By taking action to improve the tax department's efficiency and connectivity, while continuing to improve the efficiency of their tax processes and controls, tax departments in Italy can free up resources to focus on higher value strategic and business support activities.

Only 40%
of restructurings aim to better align the tax department with the business and/or finance function

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 functions and identifying operational benchmarks for high-performing tax teams.
- For the current survey, 1,150 heads of tax in 22 countries, including 50 respondents in Italy, 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.

kpmg.com/socialmedia

Designed by Evalueserve.

Publication name: Good, Better, Best – Italy

Publication number: 121477

Publication date: March 2013