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cutting through complexity

TAX

Good, Better, Best

South Africa

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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 South Africa

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

- **reporting greater interest and interaction between boards, upper management and tax departments** in developing a tax department strategy that is consistent with the company's overall business strategy
- **ahead of the global peers in centralising and standardising tax department activities**, for reasons such as the reliance on South African tax teams to service operations across Africa and the prevalence of financial services companies in South Africa
- **spending twice as much time on tax compliance, financial reporting and tax audit management** than they are on other, more value-adding pursuits like integrating with business groups, effective tax rate optimisation and cash tax planning
- **dealing with rising levels of tax audit and controversy activity and pressure to reduce costs**, which could further limit their time available for collaborating with colleagues across the business and other value-adding pursuits unless further investments are made in technology and processes to enhance their efficiency.

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

Clarifying accountabilities – board interest in tax matters increases

For South Africa-based multinational companies, it has become common practice to have a tax strategy that is consistent with the company's overall business strategy – 98 per cent of South Africa-based respondents say they have such a strategy currently, which is higher than the result of 93 per cent achieved in 2009 and the current global result of 93 per cent.

Respondents from South African also report greater interest and interaction between boards, upper management and tax departments in developing the company's tax strategy. The percentage of respondents who say their tax strategy has board-level approval rose from 63 per cent in 2009 to 76 per cent currently. For 78 per cent of South Africa-based respondents, the board and/or corporate leadership are directly involved in providing guidance on the tax strategy – an increase from 2009 (70 per cent) and slightly higher than the global average (73 per cent).

A potential reason why higher levels of board engagement in tax governance are reported is the prevalence of global financial services companies in South Africa, which represent 24 per cent of South Africa-based respondents. Around the world, financial services companies are facing a wave of regulatory and public pressure to improve their governance and controls, which could have contributed to the improved results related to the level of board attention to their company's tax affairs.

98%
of South Africa-based tax departments have a strategy that aligns with their overall business strategy

76%
of tax department strategies are board-approved

Additionally, tax audit and controversy activity has increased markedly since 2009, which may be attracting more board-level attention. Currently, 66 per cent of South African-based respondents are involved in some form of tax controversy. Reported levels of disputes have risen sharply in the past 3 years and, in many taxation areas, tax dispute levels are much higher than globally. For example:

- 48 per cent of South Africa-based respondents say they are currently involved in corporate income tax controversy, up from 25 per cent in 2009
- 48 per cent are involved in indirect tax (sales/use or VAT/GST) controversy, up from 33 per cent
- 40 per cent are involved in disputes involving people taxes (social security, personal income taxes, etc.), up from 18 per cent
- 30 per cent are involved in disputed involving transfer pricing, up from 15 per cent.

In the future, tax controversy may rise even higher in South Africa as the tax authorities are expected to continue to take more interest in how tax departments are managed, for example, by scrutinising tax and accounting processes and controls, tax strategy and risk management.

Almost 1/2
of South Africa-based respondents are involved in corporate income tax controversy, compared to **34%** globally

Only 34%
are not involved in any tax controversy, compared to **38%** globally

Driving efficiency – high focus on centralisation and standardisation

Management and coordination of global tax departments is often achieved by leading companies by centralising their activities in headquarters tax departments. As in 2009, South Africa-based respondents report high levels of tax department centralisation. Currently, 78 per cent of respondents say their company has a headquarters tax department that directs, manages and coordinates the global tax department, which is close to levels reported in 2009 and globally in the current survey.

78%
of South Africa-based respondents have a headquarters tax department

This may reflect the fact that global companies based in South Africa are relied on to manage the tax affairs of the company throughout Africa, creating a greater need for centralised management and direction of tax in less developed locales. For the same reason, South Africa-based respondents are more likely than their global peers to report having employees with tax responsibilities for:

- particular regions or multiple countries (64 per cent in South Africa versus 52 per cent globally),
- single countries (74 per cent in South Africa versus 54 per cent globally)
- business units or divisions (70 per cent in South Africa versus 55 per cent globally).

South Africa-based respondents report higher levels of standardisation of their global tax departments and activities than their global peers, which could stem partly from the prevalence of respondents from financial services companies and their need to supply standardised information through automated systems.

The most standardised areas of the global tax department for South Africa-based companies are in tax staff accountabilities, followed by controls and policies and procedures. In terms of the annual tax compliance cycle (from forecasting through financial reporting, filing of returns and reconciliation), levels of standardisation reported by South Africa-based respondents are also well above global averages.

There is evidence that South African-based tax departments are becoming better at leveraging their sourcing models, for example, by making more extensive use of outsourcing, co-sourcing and shared service centres. Currently, 44 per cent of respondents from South Africa say they use outsourcing to carry out or support tax department responsibilities, compared with 34 per cent globally; 34 per cent use a finance or accounting shared service centre to support the tax department, and 32 per cent rely on other finance resources for this purpose.

Improved management and visibility over compliance activities and lack of availability of internal resources to complete work were named as the most important characteristics driving decisions on what compliance activities to outsource or co-source.

The types of work that are most frequently outsourced currently are in the areas of corporate income tax compliance, tax controversy support, overseas income tax compliance and tax planning and business support. This suggests that South Africa-based tax departments are becoming more strategic in their sourcing and more confident in accessing specialised tax resources when a business need arises.

Promoting connectivity – compliance work leaves little time for adding value

South Africa-based tax departments 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.

When asked where they expect their tax department would devote its time over the next 12 months, South Africa-based respondents gave the highest rankings to tax compliance and financial reporting. These activities are expected to occupy 20 per cent and 21 per cent of tax department time respectively, while managing tax audits is expected to take up 11 per cent.

However, integration with business groups and early indication of non-routine transactions is expected to occupy only 8 per cent of tax department time. Other value-adding pursuits are also allotted less time in the coming year: only 10 per cent of tax department time will be spent on optimising the effective tax rate and only 8 per cent will be spent on cash tax savings and tax deferrals.

In light of rising tax audit scrutiny and controversy in South Africa and other markets, it seems likely that tax departments in South African will have to devote even more time to compliance and managing tax audits in the future than they do now, especially given the mounting pressure to reduce costs in the current economic environment. As a result, they could soon have even less time and resources to devote to more value-adding pursuits than they do now.

However, most South African-based respondents appear satisfied with the current situation: 88 per cent of them believe their administrative budget is sufficient, and 72 per cent believe the level of investment in technology and tax process improvement in their tax department is "just right". Only 20 per cent of South Africa-based companies expect their tax department structure to change in the near future.

With this acceptance of the status quo, tax departments run the risk of falling ever more behind. Nevertheless, there are signs that some forward-thinking tax departments based in the country are set to pursue additional performance improvements. Of the 20 per cent of tax departments that will be restructured, better alignment with business and or finance function structure and needs was named most often (60 per cent) as the primary reason for the change (together with improving risk management, also named by 60 per cent).

Additionally, 60 per cent of South Africa-based respondents have set key performance indicators to measure integration with business groups and identification of non-routine transactions (compared to 49 per cent globally). This suggests that these companies are aware of the importance of these value-adding activities, even though they are given lower priority than lower-value compliance and financial reporting work.

As compliance burdens and pressure to cut costs continue to rise, South Africa-based tax departments will find it ever more difficult to integrate with their colleagues across the business to provide effective, real-time support to business activity and influence the bottom line. By taking action to improve the department's connectivity, while continuing to improve the efficiency of their tax processes and controls, tax departments in South Africa have significant opportunities to enhance their value and profile within the company.

52%
of tax department time will be spent on tax compliance, financial reporting and managing tax audits

26%
of time will be spent on integration with the business, optimising ETR and cash tax savings/tax deferral

76%
of South Africa-based respondents say their administrative budget is sufficient

20%
expect their tax department to be restructured in the near future

60%
of tax department restructurings aim to improve alignment with the business

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 current survey, 1,150 heads of tax in 22 countries, including 50 respondents from South Africa, 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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