Transforming tax – under pressure

Tax departments are feeling the heat. A tsunami of changes is causing them to rethink their purpose and review how they operate. Mark Body, director, tax transformation (financial services) at KPMG in the UK, considers how corporate tax leaders are adapting to the changes, and what the future is likely to hold for them and their teams.

The tax environment is in a state of flux. Continuing economic uncertainty is increasing pressure on costs. Globalisation continues to drive the centralisation of finance and tax functions. Companies are expected to increase their tax governance, accountability and transparency. Meanwhile, recent regulations require greater disclosure of global tax data to tax authorities while increased public scrutiny of companies' tax arrangements is leading to government demands for 'fair share' tax payments where profits are earned.

To see what companies are doing to face up to these changes, KPMG and *International Tax Review* conducted a survey of in-house senior tax personnel from large multinationals and UK companies and groups to assess how businesses are adapting their tax models, teams, and processes.

A tsunami of changes is forcing tax departments to rethink how they operate

The headlines

A number of themes emerged from the survey results:

- The two biggest drivers for change are increased regulation and changing tax legislation, and greater tax transparency. The latter has led to changes in regulatory and fiscal policy; this, combined with greater competition for tax revenues, is creating a perfect storm for tax within multinational groups;
- These changes have brought internal pressure to bear on tax departments. Nearly 90% say they now have to demonstrate the value they bring to the organisation. The demand for even greater value is one of the three greatest challenges tax heads face: the others are managing system and process changes, and changing business and finance models;
- Despite the demand to demonstrate greater value, insights from the tax function are used to inform business decisions in slightly more than 70% of organisations;
- Technology is changing the face of tax departments. Tax operating models are evolving because of new technology in two thirds of the organisations surveyed;
- Almost three quarters of respondents believe that data and analytics will be the most valuable technology for tax. Most use ERP systems, audit reports and their intranet to collect the data used for current tax analytics; and
- More than 80% are evaluating the talent in their tax function. They are either investing in training, recruiting data analysts, or looking at outsourcing opportunities.

Why tax functions need to transform

The survey results show just how much the new tax landscape is affecting the tax function. Stakeholder attitudes have shifted from indifference to interest, leading to changes in laws and regulations to make companies' tax affairs more open to public scrutiny than ever before. Meanwhile, UK companies have to publish their tax strategy in another move that cements tax's place on the board's agenda.

At the same time, tax departments are being asked to do more with less. Globalisation continues to spur the centralisation of back-office functions. Managing tax across the organisation has become increasingly complex, with companies expected to improve their governance, accountability and transparency.

In the past, the sole measurement of the tax function was the effective tax rate. This is shifting. What worked well in the past is no longer enough in today's world. A better way for tax to align itself today is to move away from being a back-office function to supporting the business – being more business facing and more aware of its objectives and strategies. This kind of tax function knows where the vulnerabilities lie across the organisation, making sure risks are being controlled and mitigated, and having clear roles and responsibilities about the way tax is managed.

The tax function is expected to manage compliance and reporting processes, provide transactional tax advice and manage relationships with tax authorities. All this while disclosing tax strategies and dealing with initiatives such as BEPS, the common reporting standard and country-by-country reporting.

These pressures are forcing companies to adapt their tax function and the way they manage tax. The new tax operating model has to be fit for purpose in today's environment – and capable of adapting to tomorrow's. Strategies and policies around the management of taxes need to be robust and, where possible, technology should be used to drive greater efficiency, control and oversight.

Organisations are now looking to have an effective operational model that manages taxes across their firm and through the markets and territories in which they operate. This model has to enable them to meet their tax compliance and reporting obligations in a coherent and simplified manner while ensuring they pay their fair share of tax. It also manages tax risk effectively and within appropriate and determined tolerance levels.

The features of tomorrow's tax operating model

We believe seven pillars underpin a successful tax operating model.

Governance and risk: Designing and implementing a coherent tax strategy, tax policy and risk framework to enable the effective management of taxes. The aim is to balance costs with an appropriate level of control.

Organisational model: Organising the tax function to maximise its efficiency and effectiveness within the business. This can lead to economies of scale by using data gathering centres and functional efficiencies through skills centres for judgment issues.

People and capability: Developing programmes to nurture and retain tax talent across the organisation. This hinges on maintaining a culture of continuous improvement.

Process and responsibility: Redesigning processes to maximise efficiency across the business. Organisations need to be enabled to develop the right source model to meet their regulatory and compliance obligations so they can simplify processes, maintain one version of the truth, and achieve the right answers first time.

Data and information: Focusing on data quality to minimise data re-work and increase control. This relies on integrating tax and finance systems, standardising data structures to improve consistency and the quality of reporting.

Systems and technology: Using technology more effectively to enable process efficiency and the increased use of data. A range of integrated tax technology solutions enable tax processes to be delivered and managed more effectively, removing tax professionals from day-to-day routine activity to using analytics to highlight outliers and give a wider view of the tax impact on the organisation.

Performance management: Reviewing performance measures that allow tax functions to demonstrate value. Tax function KPIs need to be aligned to wider business objectives while supporting the tax function to show it is delivering on its own objectives.

What a well-aligned tax operating model can achieve

Tax is now firmly on the board agenda. The directors need to set the tax strategy; but they must have confidence in the tax function to carry this out. Creating clear lines of accountability and governance clarifies reporting responsibilities, ensuring that the structures needed to carry out the tax strategy are in place.

In a sound operating model, tax leaders have a clear vision of the top and emerging risks and objectives for tax across the organisation. Clearly aligning operating structures and ways of working with the business and finance strategy can drive the tax function to meet its overall vision and strategic objectives, creating a strong business case for change. This helps tax react better to change, structuring itself around external factors and increasing its agility and responsiveness.

A good operating model should align the tax function with the business. This is vital as business often does not recognise potential tax issues. Once the tax function services the operational side well, it will be clear just how effective a business partner tax can be. The greater understanding of business activities, risks, and their impact on tax will feed through to a virtuous circle of greater value and more effective business decisions.

Cost has always been the driver for change: the tax operating model case is no different. Pushing the tax function towards an appropriate cost base can reduce complexity, duplication and waste, while enabling effective investment priorities to be followed through.

Meanwhile a more aligned tax function will help identify and mitigate tax risks. By making sure tax obligations are accurately calculated, reported when they need to be and met in an efficient and timely basis, a company reduces tax leakage and mitigates the risk of bearing the costs of not accurately collecting the right taxes from its customers and employees.

Having an effective operating model, in which the company fulfils all its duties and obligations in good time and accurately, will gain the trust of the tax authority. Showing an open and transparent approach can increase that trust, securing a lower risk profile with the tax authority. This means fewer enquiries, fewer audits, and less intrusion into tax affairs – freeing up resources and helping keep down costs.

The clock is ticking on all this. As tax authorities get a grip on data mining and analytics, organisations are realising they need to have a better understanding of their data – and fast. Many tax leaders we speak to are frank: they know they have poor data and inadequate systems. But they also appreciate that this situation cannot continue. In a world in which tax authorities are shedding tax trained staff to hire data analysts, companies cannot risk getting left behind. Their concern is when the tax authorities get hold of the organisation's data in real time – something that is already happening to a limited extent in countries such as Brazil, Spain and the UK – they will open enquiries into the quality of data and treatment of items in prior year returns.

Meeting the challenges

Tax is part of the board's agenda as never before. The financial consequences of getting it wrong, through penalties and interest charges, are rising.

The potential for reputational damage is immense. Nobody wants to see their company's name as front page news because of their tax affairs. What's more, companies want to ensure that they act in a manner that their customers, shareholders and employees expect of them.

It is no longer feasible for companies not to change because they have not had an issue in the past. The calling out of a number of businesses because of their tax affairs has led to a seismic shift in the tax landscape and greater demand from the public around corporations paying their fair share of tax. The times are changing. Tax authorities are driving for better tax control frameworks and increased transparency. This means all tax functions must review their operating model to ensure they can cope with today's demands – and be flexible enough to adapt to those of tomorrow.

Meanwhile business needs are changing too. The tax function can no longer be a back-office backwater, but has to transform into a key business partner that should be part of board discussions and help the organisation achieve its wider strategy. For a business to achieve the full potential value of the tax function, it needs to be prepared to invest in adapting tax models to face the new realities. Tax functions, for their part, need to be able to make the strong business case for this adaptation and investment, showing how they can support the business and help it meets its objectives.

The challenge is for tax functions to make the business case where there is no immediate problem. The simple answer is that the cost of doing nothing is far greater than the cost of doing something. By not investing and not having in place an appropriate and flexible tax operating model and using appropriate tax technology and systems, companies open themselves to financial loss and reputational damage, while closing off the benefits that a more integrated tax function can bring to the wider business. This is no time for inertia. Companies that want to protect their future need to act on their operating models now.