Banking & capital markets 2020
Is your business equipped with a tax function for the future?

The global tax landscape and the banking and capital markets industry are both in a state of rapid and constant change primarily as a result of a more global and technologically-advanced world. These changes directly impact the function and expectation of a tax department.

Is your business equipped to handle the challenges of 2020? If not, does your tax department know what it needs to do in order to optimise its function in 2020?

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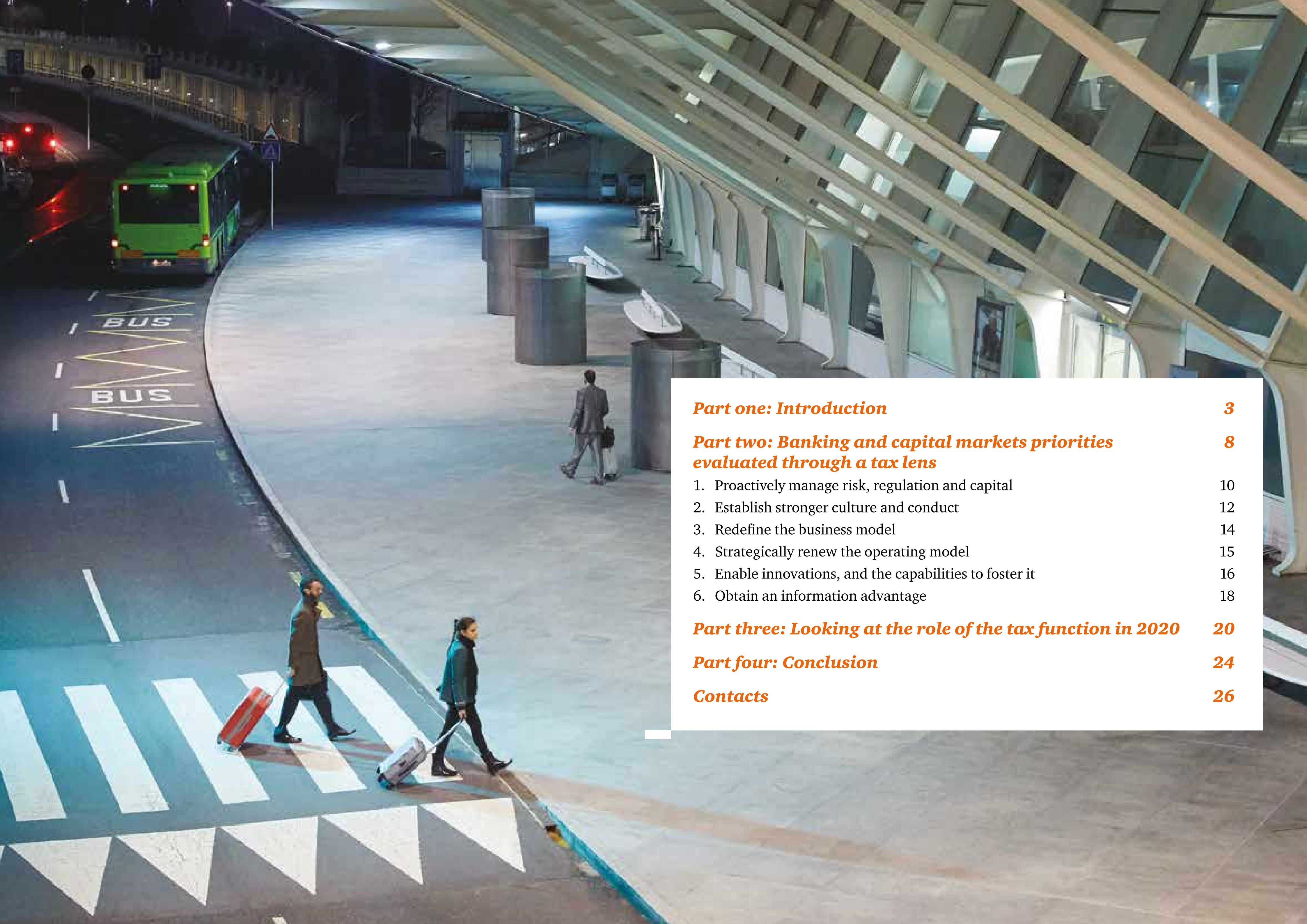
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Introduction

The global tax landscape and the banking and capital markets industry are both in a state of rapid and constant change primarily as a result of a more global and technologically-advanced world. These changes directly impact the function and expectation of a tax department. Is your business equipped to handle the challenges of 2020? If not, does your tax department know what it needs to do in order to optimise its function in 2020?

In order to be effective in the future, the tax department needs to assess its current state and develop an expectation and vision for the future.

The global tax landscape and the banking and capital markets industry are both in a state of rapid and constant change primarily as a result of a more global and technologically-advanced world. These changes directly impact the function and expectation of a tax department. Is your business equipped to handle the challenges of 2020? If not, does your tax department know what it needs to do in order to optimise its function in 2020?

The world has been permanently changed by the 2008 financial crisis. Three easily observable consequences are 1) global and local governments lost revenue 2) the financial markets and financial companies lost trust and 3) companies, especially banking and capital markets participants, suffered losses. Out of these consequences, we have seen the industry look for new sources of revenue and ways to manage costs and also face more rigorous audits and compliance burdens – and the area of taxation is no exception.

Industry players have faced significant challenges in attempting to regain profitability in a post-financial crisis era and the new landscape has not quite been formed and new challenges arrive each day. For example, the impact of ultra-low interest rates has had unintended and unforeseen consequences such as negative interest rates. Governments are also evaluating the impact on tax revenue from the almost decade long period of expansionary monetary policies which can result in unanticipated tax losses or smaller profits.

"We must anticipate further change. For example, the media attention on US headquartered companies 'inverting' highlights the need for comprehensive US tax reform."

Joseph Foy
Global Banking & Capital Markets
Tax Leader
Partner, PwC US

Over two-thirds of our surveyed respondents agree or strongly agree that there will be increased instability in the capital markets over the next five years.

"According to PwC's 18th Annual CEO Survey, 89% of BCM CEOs are concerned with over-regulation, up from 80% in the prior year."

The tax enviroment is also changing, and while the changes are not unique to the banking and capital markets (BCM) industry, being the face of the 2008 financial crisis means any change has an exacerbated impact on the industry. For example, the OECD's Base Erosion and Profit Shifting (BEPS) project has undoubtedly impacted the BCM companies continued effort to increase transparency and regain trust in the post-financial crisis world despite the fact that this industry was not the likely target of this project.

Other changes in the tax landscape have been an increase in global compliance requirements, including the European Union's (EU's) Common Reporting Standard (CRS) and US Foreign Account Tax Compliance Act (FATCA). Local tax reforms – the UK's Diverted Profits Tax (DPT), new anti-avoidance rules in Australia, new controls on related party payments in Mexico and expanded documentation requirements in the United States (US) for intercompany debt outlined in the proposed 385 regulations – continue to disrupt the industry.

While some of the legislation has not been directed at the banking industry, other legislation, such as the treatment of dividend equivalent payments in the US by section 871(m), has been. Some of these developments have been on the radar for some time, but the operational impact is only now becoming evident.

Just by discussing the recent, unprecedented changes, one can see it is very challenging to manage a tax department today. However, we must anticipate further change. In the US alone, we anticipate comprehensive tax reform, the need for it which is highlighted by the media attention on US headquartered companies 'inverting.' The complete impact of the recent vote for the UK to exit the EU is still not known, but we know it can cause a considerable impact on tax liabilities and tax planning if workforce and/or entities relocate out of London.

A tax department has to keep pace not only with the change in global tax policy and basic compliance requirements, but also with the change in a company's business driven by the individual organisation, the industry as a whole, and the broader marketplace. The pace of change in all areas is faster than ever and enabled by technology. In order for a tax department to be prepared for the year 2020 and beyond, the tax department must take action now.

Step one: Assess the current state of the tax department

The first step is for you to assess the current capabilities of your department in governance, data, technology, process and people. The maturity model depicted on the following page can help identify the maturity level of the tax department's current capabilities.

Where to start: A tax strategy and roadmap

*Tax function maturity model**

Where are you now? Where do you want to be?

5

Level 5: Optimised
Processes are efficient, based on best practices and continuously monitored for improvement opportunities. Deliverables are high quality and the organisation is able to adapt quickly. Integrated portal access crosses functions with advanced automated workflow, embedded controls, analytics and rules with actionable insight.

4

Level 4: Managed
Processes are actively monitored and deviations are detected in time. Processes are continuously improved in the area of efficiency. Technology tools are aligned with the overall organisation and integrated, providing some predictive analytics. Robust controls define the process.

3

Level 3: Standardised
Processes are standardised, documented and communicated (e.g., through training). Compliance with these processes is still very personal. Deviations from the written procedure may remain unnoticed. Technology includes a mix of licensed software plus a tax sensitised ERP or tax data hub(s). Minimally acceptable internal controls are followed.

2

Level 2: Informal
Roles and responsibilities are mostly informal and the execution is based on experience within the processes. There is no formal training, communication or standardisation. Licensed software is used with limited integration and internal controls are limited.

1

Level 1: Initial
The organisation is mainly incident driven. Issues are addressed and handled at the time of occurrence on an ad-hoc basis. Basic software is used but is not integrated and no internal controls are in place.

In developing the future roadmap, we first need to dive into what changes are anticipated in the industry.

* The naming of the different levels refers to an internationally accepted Risk Management model COBIT and is descriptive only. The Maturity Levels are general guidelines for information purposes only. No conclusions or warranties may be derived from a (name of a) Maturity Level.

'Optimised' does not refer to a perfect or error free situation.

"The vast majority (93%) of our surveyed respondents agree that it is important for their organisations to use technology as a tool to gain a competitive advantage, as well as to facilitate operational and regulatory change. Furthermore, nearly three-quarters of the respondents expect to invest more than 11% of their capital budgets into technology."

Step two: Develop the future state of the tax department

The second step is to develop your future state. As with any tax analysis, you have to first start by evaluating the business environment and industry. The four global macro-trends shaping 2020: global instability, the rise of state directed capitalism, technology, and war for resources according to a PwC report *Capital Markets 2020 – Will it change for Good?*

First, global instability is highly likely through 2020 and beyond. Over two thirds of our surveyed respondents agree or strongly agree that there will be increased instability in the capital markets over the next five years. A lot of factors will contribute to global instability. Conflict between sovereign nations will continue to rise, heightening the risk that certain countries will be restricted or entirely cut off from access to capital markets and financial infrastructure. We will also begin to see the implications of increased regulation and consequences of divergence of regulators' policies and practices across regions. According to PwC's 18th Annual CEO Survey, 89% of BCM CEOs are concerned with overregulation, up from 80% in the prior year. Governments will be inevitably forced to retreat from fiscal stimulus programmes and raise interest rates, as we have seen through actions by the Federal Reserve Board. The impact of this is unknown but it could potentially undermine a still fragile economy. This is a particularly significant concern, as according to the respondents of the 2015 Banking Banana Skins survey, the possibility that economic recovery will fail is the number one greatest threat. Finally, in global instability, there is a range of factors contributing to political and social unrest, including fiscal austerity, scarcity of resources, corruption, social media and religious conflict.

Second, regulation facing the capital markets industry, particularly the banking sector, is contributing to both global instability and also a rise in state directed capitalism. Nations have undertaken prescriptive rule-making, as they learned a global banking system is local in a crisis. This regulation shifted the focus on policy makers from facilitating the efficient movement of capital to domestic policy agenda and protecting sovereigns. We will begin to see unintended consequences from the wide-spread government intervention, and start to predict what other policy measures the governments will undertake.

Third, technology has always been changing the world in unpredictable ways, but as the change in technology continues to accelerate, so will the impact on capital markets. This industry has seen technology change the trading side of the business, while the rest of the business has been largely overlooked. The vast majority (93%) of our surveyed respondents agree that it is important for their organisations to use technology as a tool to gain a competitive advantage, as well as to facilitate operational and regulatory change. Furthermore, nearly three-quarters of the respondents expect to invest more than 11% of their capital budgets into technology.

This industry will be forced to enable technology to better relate to clients (specifically in the retail and commercial banking sectors as mentioned in the PwC's Retail Banking 2020 paper, the need to bolster analytical capabilities and mobile access to better understand and serve the customer) and better manage their own internal operations and access their own data (e.g., centralised view of data by geography, produce, and client). With the continued expansion of block chain technology (the technology behind bitcoin) we know this industry will be revolutionised.

Many oranisations have varying, fragmented systems (from mergers, acquisitions and/or reorganisations) and outdated systems which do not function for the changed business and are not configured to meet regulatory demands. How each player will respond to the change in the technology landscape will depend on its strategic objectives, the legacy technology considerations and the technology available. Regardless, we believe that cost reduction opportunities and pressures to stay ahead of market trends will force change.

Fourth, scarcity of resources and the impact of climate change are already of paramount importance. The "war for resources" (e.g., goods, water, minerals, and capital) will increase market volatility, generate new regulations, and re-enforce protectionist behaviours in many countries and regions. However, we see a bright side to these trends because free and fair capital markets will remain the most efficient means to help alleviate some of the global tensions by assisting in allocating resources where they are most scarce. The opportunities for the financial services sector to support this transition will be significant and lead to both new markets and clients.

Given these global macro-trends, we see six priorities that bank tax departments need to consider for success in 2020.

Step 3: Develop a transformation roadmap

The third step in preparing your tax department for the future is developing a transformation roadmap outlined in the conclusion.

2

Banking and capital markets priorities evaluated through a tax lens


To stay competitive through 2020, six priorities should be confronted to emerge as leaders.
1
Proactively manage risk, regulation and capital
2
Establish stronger culture and conduct
3
Redefine the business model
4
Strategically renew the operating model
5
Enable innovation and the capabilities that foster it
6
Obtain an information advantage

1

Proactively manage risk, regulation and capital

Managing tax risk has always been a challenge and a goal for every business, but as risk management in general continues to be a high priority, so does the management of tax risk.

Regulatory response must be proactive and increasingly integrated into business-as-usual practices. Risk and capital should be managed holistically throughout the enterprise and with an end-to-end analytical rigour to succeed in a complex and dynamic ecosystem.

This is exceptionally difficult given the sheer volume of new regulations and reporting requirements faced by many market participants. Not only does the sector have to comply with new mandates and potentially report to new supervisors, but it also must address the unintended consequences.

There is an increasing concern that these burdensome requirements may not have resulted in more effective risk management. Is the industry checking boxes on a risk management checklist instead of proactively and uniquely managing its own risk? At the same time, not all participants are faced with equal regulation burdens. The increased regulation of the banks has fuelled the growth of the shadow banking sector and changing the competition in the industry, the effects of which are still unfolding.

Managing risk has been a key area of focus for this industry which was highlighted in the most dramatic way by the 2008 financial crisis. Even eight years later, one of the largest concerns highlighted by the 2015 Banking Banana Skins report is the quality of banks' risk management which, based on the respondents, is an increasing concern, rising up from No. 11 in 2014 to No. 6 in 2015. The LIBOR and forex price manipulation are examples that risk management is not operating effectively.

The way tax risk is managed is also changing from reactive to proactive; many jurisdictions may begin to require the adoption of a tax control framework which follows guidelines similar to Sarbanes-Oxley and COSO (Committee of Sponsoring Organizations for the Treadway Commission). There are unique issues if the tax department is fragmented, such as operational taxes being managed outside of the traditional tax team with potentially different reporting lines. The tax function must implement these frameworks and ensure they respect local rules and guidelines.

The proactive management of tax risk will require your tax department to anticipate future changes in the industry, company and tax environment. This may require your tax department to model the tax impact of future business and workforce changes including various scenarios. The tax department cannot do this alone but it will need to be in conjunction with the business – the management of tax risk should become integrated into the overall risk management of the company, if it is not already.

Managing dynamic risk is difficult, and we expect tax risk to grow and the areas of importance to shift. First, global tax reporting requirements will continue to grow exponentially and have a material impact on operations. This means the tax function needs the budget and the wherewithal to comply. Second, tax authorities' knowledge is increasing as both global information sharing among tax authorities and across jurisdictions becomes the standard and they increase their capability to mine data. There is the risk of noncompliance, overpayment of tax, double tax, but also paying one's fair share of taxes.

It is important that companies pay the fair amount of tax in any one jurisdiction and also share taxes appropriately across the globe. This will continue to be a challenge with the growth and importance of emerging markets in the global economy, especially as developed and developing nations contribute different skills and value these skills differently. The payment of fair taxes plays directly into a company's reputation, especially in this industry, as taxpayers feel they had to unfairly bail-out many market participants.

The tax department has a huge challenge in this area to be able to manage its risk while the business side is managing its increasing and changing regulatory obligations. While it is one organisation, there will be almost a tug-of-war for resources to meet compliance requirements.

Regulatory and compliance issues, including tax, are at the top of the agendas of every banking and capital markets participant. The rules are complex, and the attitude of regulators, supported by politicians and public opinion, is deeply suspicious of financial institutions. Regulators are increasingly less flexible in their demands to improve compliance, reporting, risk controls and the underlying business processes and data. This rings true for the global tax regulators, and the challenge will be gaining the tools and budget to have the resources to effectively manage the tax risk.

"While tax risk is a component of overall risk, getting increased budget and attention dedicated to tax could be difficult."

2

Establish stronger culture and conduct

In PwC's Capital Markets 2020 survey, 90% of respondents believe that it is important to establish a strong conduct and culture focused on higher ethical standards.

To respond to regulatory and market criticism, participants must change for good and embrace a cultural transformation that fosters transparency and high professional standards while minimising conflicts of interest. In our Capital Markets 2020 survey, 90% of respondents believe that it is important to establish a strong conduct and culture focused on higher ethical standards. These changes will increasingly become key value drivers and differentiators of the future as society assesses the social utility of capital markets and its participants.

The banking and capital markets sector is still trying to rebuild its brand and regain trust in the public. It has been an uphill battle and will continue to be a challenge for companies, although perhaps there is no downside risk as there has been quite extensive damage done to date. This view is reflected in the 2015 Banking Banana Skins report where respondents did not rank reputational risk as a top ten concern.

One way to restore this confidence is through increasing transparency and continuing to change the corporate culture. While the downside risk is unclear, we do know the industry does not have an excess of goodwill to afford any further damage to its reputation or lose any trust it may have regained - this includes the company's treatment of its tax compliance responsibilities and its tax liabilities.

The banking and capital markets industry must treat its tax affairs more delicately, to avoid any further reputational damage (from taxes or other sources). The industry also plays such an important role in global economic growth; it is often held to an even higher ethical standard than most. Reputational tax risk is particularly relevant because a tax news story is often coloured with a sense of fraud, corporate greed, and/or lack of equity into the spotlight – all sentiments that this industry in particular does not want to be associated with.

An increase in transparency is pervasive in the tax side of the house. Currently, the UK requires banks to disclose its tax policies which could become standard in many other countries. Similarly, we anticipate jurisdictions will require the public disclosure of its country-by-country reporting. The EU already requires the public disclosure of the country-by-country reporting for EU regulated institutions as part of the Capital Requirements Directive IV issued to implement the requirements of Basel III.

PwC's Total Tax Contribution (TCC) framework is one tool used to enhance transparency. The TCC quantifies the full extent of a company or industries tax contribution which is much broader than just its corporate income tax liability. The TCC is used to increase communication and build trust with a range of stakeholders and the public overall.

In 2009, the UK introduced the Code of Practice for Taxation and Banks (and renewed it in 2013) which applies to banks and any firm in the scope of the UK bank levy. It is one element of the government's anti-avoidance strategies and is designed to change the attitude and behaviours of banks towards tax avoidance.

We have seen, and predict that we will continue to see, a shift from companies being rewarded by investors solely for tax minimisation to also being rewarded for tax transparency and the payment of its fair share of taxes. It is a common theme among all industries, highlighted by the OECD BEPS project which calls to the forefront the concept of tax being paid on global profits fairly in each jurisdiction. This common theme is also evidenced by the EU's concept of illegal state aid, and jurisdictions shaming other low-tax countries for being tax havens.

Decisions over the 'right' amount of tax to pay should take full account of both the reputational risks and the extent to which tax is now a key element of an entities 'license to operate' in a particular jurisdiction. The challenges are heightened by the speed with which attitudes can change. This means that what was seen as acceptable when the planning was carried out can become a source of controversy by the time a tax audit is due.

3

Redefine the business model

The industry still isn't sure what the future holds in a post-financial crisis world. It is still finding its new equilibrium.

The recovery years have mainly been focused on first survival and then compliance with new regulatory burdens. The industry has still only recently been able to focus strategically in creating and executing a new business model. This business model change is required in order to adapt to the new competitors, new customers and demographics, and to maximise profits in a high-cost operating environment. This shift in business model is enabled by technology and it will be interesting to see how blockchain technology transforms financial services firms. Financial institutions will look to rationalise their offerings, country footprints and the clients they serve on the way to building simpler business models.

The business is in a constant state of change, forced to continually evaluate, rethink and redefine its business model. The banking and capital markets players will have to consider which clients to prioritise, which geographies and business to enter or exit, and which products to shed. We have seen this in the past and we predict to see this in the future, as the banking and capital markets industry has still not yet found its new normalised state.

As with any aspect of change, the tax function has a big challenge and big opportunity to be a strategic partner with the business. This is not necessarily a unique position for the tax department but given the shift in tax policies and attitude in the past several combined with the magnitude of potential change, the tax function must stay even closer to the business to properly manage tax risk. It also has a responsibility to have the capabilities, bandwidth, agility, and technology to provide the tax support to foster these changes. The tax department could stay back and be reactionary in its role in supporting the business, but it could also step up and proactively become a partner. This can only be achieved if the tax function is properly equipped.

Recently we have seen banks consider or begin to acquire technology companies. This will have a big impact on the tax department of your company – it will accelerate the pace of change in the business model, require tax technical capabilities to manage the acquisitions, and result in the need to address the operational issues typical to the integration of a new business. However, this will also bring new and unique tax issues to the forefront, such as how to properly tax intellectual property, an area of tax law which may be new to banking and capital markets players.

4

Strategically renew the operating model

IT automation, consolidation and utilisation of middle office and back office activities will simplify operating models, reduce costs and improve profitability.

Financial institutions have been focused on reducing costs to match smaller revenues and compensate for higher regulatory expenditures. Almost every organisation has launched some form of cost reduction and business re-engineering effort. Yet privately, executives confirm to us what we can see, which is that little real reengineering has been done. Expense ratios remain high in a declining revenue environment and RoEs are below the cost of capital at many institutions.

One of the reasons for this is that over the past decade, intricate (and costly) operating models have been developed driven by mergers, acquisitions and half integrated businesses. This is seen in the tax function as well as the business side. This operating model is unsustainable; it is going to get worse as the business is being redefined. We know the tax function is facing the same issues, although perhaps even worse. The cost of operating models on the business front have likely been revamped in some way over the past several decades, where the operations of the tax function, not being a front office unit, may not have.

As the operating model changes, one key aspect of this is to ensure your company is proactively engaging in talent management to ensure you have the right people with the right skills in the right jobs, when and where they are needed. As financial services companies relocate, restructure and refocus – significant changes will occur to the demands and supply of the talent pool which could result in a gap in personnel to meet your business needs. Furthermore, it is still unclear how quickly and profoundly the use of artificial intelligence and robotics will change job responsibilities, but this variable needs to be accounted for when formulating the future of any tax department.

The tax department will face the same challenges as the broader organisation but with unique considerations such as ensuring that the department has technical skills relevant to the jurisdiction and/or new legal form the modified business is operating in. The after-tax profits of the entity can be drastically impacted by a change in operating jurisdiction and legal form due to differences in counties tax systems and the inconsistent treatment of items.

Again the tax function has a big challenge. The tax function needs to reduce its costs, to be in line with the overall cost reduction model of the business, while facing increased compliance burdens and competing for resources and undergoing expensive change.

There is a unique responsibility of the tax department to manage its costs in performing a function for the organisation, but also the tax liability of the enterprise. It is a balancing act to manage as the two goals can be conflicting and facing signficant challenges (such as increasing tax liabilities both out of the decrease in the attractiveness of structured tax planning the increase in additional types of taxes). All of this has to align with the tax department's mounting pressure to pay an acceptable amount of taxes – no longer just a focus on tax minimisation – another source of conflict.

5

Enable innovations, and the capabilities to foster it

Financial services institutions are continually being forced to innovate – not only products, but also the way business is done and how it is executed. While there may be some pressing challenges to innovation, such as cost reduction and regulatory commitments, a time of stress on an industry is also when innovation is needed the most and presents an unique window of opportunity.

"PwC's Global Innovation Survey reveals that financial services falls well below other industries in its ability to manage innovation effectively."

Innovation will need to come to the forefront to drive excellence and to fill profitability gaps. Much of this innovation will come in the area of risk, capital and collateral management as opposed to the product level, which has been the historical source of innovation in capital markets.

We know innovation is a key ingredient for success and it is a crucial component for success in 2020. PwC's Global Innovation Survey reveals that financial services falls well below other industries in its ability to manage innovation effectively. It may be a challenge for the industry as a whole, but it is a challenge that must be met.

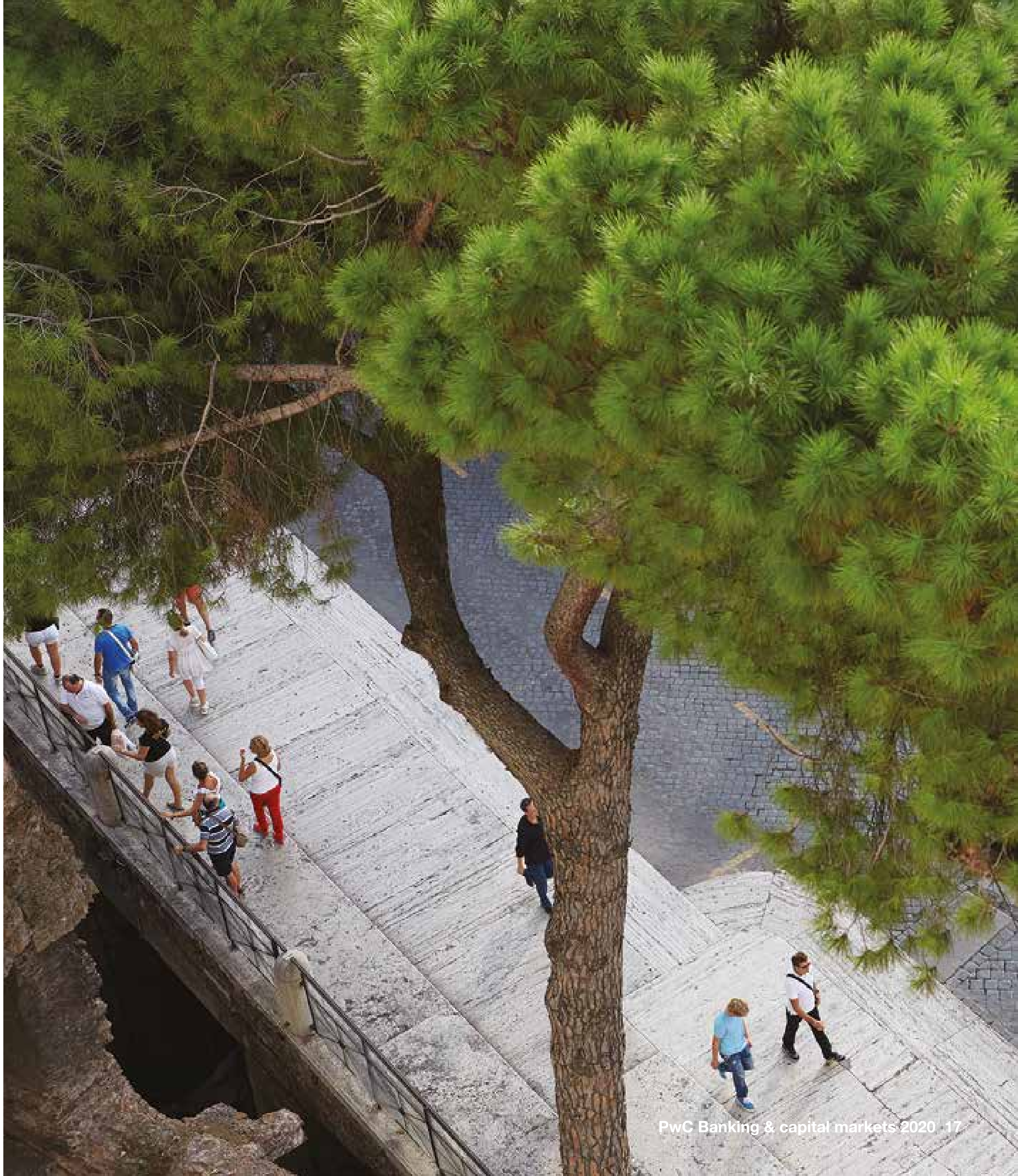
Given the business side has been on the slower side of innovation, the tax department isn't lagging too far behind. The tax department has an opportunity to catch up before the company's products, business lines, and processes far surpass the ability of the tax function to support it. The tax department is the responsible party and it needs to drive its own innovation. As always, the tax department must perform two roles and serve multiple interests at once by innovating for its own success and demands and to be in line with the expected shift in the broader corporate culture.

The tax department will be quite busy planning for and advising on the tax consequences of the business changes. For example, as the business changes its customers, geographic location and execution of its business goals, the tax exposures will change. This could be significant and result in additional issues, such as an increased or decreased risk of permanent establishments in other jurisdictions. This is a particularly difficult area to navigate as the tax landscape is also changing, with updates to the new US model income tax treaty and the evolving definition of a dependent agent.

Your company will also be faced with addressing the tax treatment of new products. Some of the products may just be new to the organisation, but others may be original to the market. New products inevitably attract risk because of their uncertain treatment – accounting, tax, legal, etc. Even the tax treatment of current derivatives and synthetic type transactions can be uncertain. We have seen that the tax law can be slow to address the treatment of financial products, given the complexity of the instruments and the taxing authorities attempt at taxing the substance of the transactions while sometimes not understanding it. Of course, the uncertainty in the tax treatment is magnified when operating a global business in a post-BEPS world.

Lastly, the tax department will be faced with determining the treatment of business transactions on a proactive basis. The tax department needs to be able to develop answers to business decisions about entering and exiting new product lines before they are asked. This means the tax department needs to be more integrated with the business. While this is already a job of the tax department, we expect this role to expand and gain importance as this sector innovates and makes decisions based on the after-tax returns. We also expect that the tax department will be expected to provide answers faster because of an assumption that the tax department is keeping pace with the technology and it has advances of the business access to proper data inputs. This translates to a potential shift in the resources needed to ensure a broader group of people have the proper technical expertise.

The ability of your company's tax function to proactively innovate and keep pace with the change in the business is of course compounded with the requirement to digest and implement changes in tax policy and law for each jurisdiction the company operates in. For example, like other industries, your company will have to continue to deal with the outcomes of BEPS, specifically the BEPS Action 2 (neutralise the effects of hybrid mismatch arrangements) and BEPS Action 4 (to limit base erosion via interest deductions and other financial payments). However, unique to the financial services industry, your company may have to address additional bank levies, surcharges and financial transactions taxes. As governments continue to innovate to find other sources of revenue, companies have to respond to properly comply with the tax and manage the costs.



Obtain an information advantage

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By harnessing the power of big data, leaders will be able to create competitive advantages in client experience, operational design, risk management and profitability.

We believe the ability to aggregate enormous amounts of data and analyse, plus interpret it, will be an absolutely minimum requirement to be in the game. Mastering 'big data' for trading purposes is one area already being aggressively addressed by banking and capital markets participants and users; however, the real challenge will be to apply the same focus outside of trading across a broad spectrum of financial institutions' internal activities: from credit analysis, instrument pricing, enterprise risk management, nimbler capital allocation and regulatory reporting – including to tax authorities across the globe and to users and investors of financial statements.

Currently, we know one common weakness in the tax function is technology – an area that has the potential to pay high-returns in efficiency, transparency, risk reduction and long-term cost management, but will also become, if it is not already, a bare minimum standard to be compliant. Tax departments often lament lack of manpower, but that often reflects a workforce that is not yet technologically savvy. The good news is the technology and tools in this area are evolving rapidly and this will allow personnel responsible for the tax function to close knowledge gaps quickly. The tax function will also be able to sharply reduce the manual effort required for tax administration, reporting and monitoring.

One revolutionary change underway is the growing penetration of blockchain technology, or distributed ledger technology, into financial technology and the broader marketplace. The significance of this technology is evidenced by numerous initiatives announced by financial services firms, the formation of a consortia to explore uses of the technology (e.g. a group of investment banks conducting mock trades), and the development of standards and interest from regulators and central banks (e.g. the Bank of England). The use of this technology will change the financial information systems and tax software. Transactions that are conducted and recorded on distributed ledgers can transform how tax data is collected, stored and processed. This will allow tax advisors, administrators and authorities to eliminate volumes of paperwork in favour of advanced analytics, thus leading to unexpected innovations which will compound the pace and magnitude of change and making the tax functions much more nimble, agile and value generating.

This technology also has a direct impact on taxation. Blockchain technology can help companies precisely track the ownership of assets, which can reduce the ambiguity and uncertainty around when and where something is taxed. We expect that more and more tax compliance software companies will explore this technology and the applications and benefits of blockchain technology seem to herald a future of far lower frictional costs in taxation and overall greater economic efficiency.

As the business transforms its technology to better handle data mining, the tax department must be included every step of the way. The revamping of the business side will help the tax function have better access to data, but without a strategic and thoughtful role in the process, the tax function will have gaps in the data it has versus the data it needs and, moreover, the data that could help transform the organisation's tax function into an optimal state.

The tax department is going to be forced to advance its technology. The fight against tax evasion by the world's governments, who are pushing for greater tax transparency, has led to the introduction of automatic exchanges of customer information by financial institutions to tax authorities. Companies need to be able to interrogate, consolidate and transmit huge amounts of sensitive data quickly, easily and in a secure and auditable form to tax authorities and customers.

Clients want tax articulate reports so that they can complete tax returns easily and accurately. Moreover, investors and other stakeholders are increasingly interested in after-tax results at the macro level but also at the transaction level. We predict after-tax indicators will be a bare minimum in the year 2020. For example, on the fund side, we expect that the total tax ratio will become as standard as the total expense ratio. This will especially be a huge challenge for global institutions that have varying data requirements in different jurisdictions, but the need to minimise costs and streamline systems.

The tax departments' technological capabilities and programs will need to continue to change and so will the technological capabilities of the personnel. The staff and management within a tax department need to be technologically literate and also savvy. The tax department may need to be trained or re-tooled and processes may need to be reconfigured. Technology will continue to provide companies with expanded capabilities and efficiencies that also may enable the personnel on the tax department to have capacity for additional and/or different areas of responsibilities.

The more the tax function can better utilise data from the business side, the more efficient the tax department will be, while at the same time lowering risk. This is true for income tax compliance, tax provision processes, withholding tax and transactional taxes.

3

Looking at the role of the tax function in 2020

The change that is causing a shift in the industry is also shifting the tax environment.

Global legislative and regulatory landscape

- Global tax information reporting requirements (e.g., country-by-country reporting and similar transparency initiatives) will grow exponentially and will have a material impact on the operations and related budget allocations within the tax function.
- Regulators will demand transparency regarding global taxation, necessitating clear and thoughtful communications with public stakeholders about corporate contributions to the communities in which they do business.
- Information sharing will be commonplace among tax jurisdictions, and taxing authorities will have the capability to mine data and conduct global audits, resulting in increased disputes.

Tax function's role in risk management and governance

- Many jurisdictions will legislatively require the adoption of a tax control framework which follows guidelines similar to Sarbanes-Oxley and COSO.
- Enhanced stakeholder scrutiny and reputational risk will force companies to continuously reevaluate their tax decisions.

Data flow into the tax function

- The majority of tax functions will receive all information in a 'tax ready format' from either their enterprise-wide financial systems or a dedicated tax data hub.
- Dedicated tax data hubs will become mainstream and be developed internally, licensed from a third party vendor, and/or accessed through an accounting form as part of a co-sourcing arrangement.
- Data security will be high on the agenda of tax functions due to concerns over confidential information being inadvertently released or shared publicly.

Technology automation for tax function analytical tasks

- More companies will use their enterprise-wide financial systems to create tax calculations (e.g., income tax accounting and indirect taxes), thereby replacing spreadsheets and/or traditional tax technology solutions.
- The vast majority of tax functions will rely on professional data analysis tools to assist in the decision-making process in areas such as detection risk, opportunity identification, projections, and scenario planning and overall business support.

Tax function roles and processes

- Most global tax preparatory compliance and reporting activities, including data collection and reconciliations will be performed within the company's shared service centre or will be co-sourced with a third party.
- Tax functions will use real-time collaboration tools to automate their workflow, document management, calendaring, and internal controls.

The tax professional of the future

- A successful tax professional of the future will be highly proficient in data analysis, statistics, and technology, as well as process improvement and change management.
- Tax functions will employ dedicated tax IT, data, and project management specialist who will develop, champion and execute the tax technology and transformation strategies.

The growing complexity and increasing demand for transparency directly results in the need for more data, better data, and analysing and interpreting data faster. Again, technology and talent management will be key to achieving these goals.

We know the business and operating model for banking and capital markets companies has changed and will continue to change – both as a need in response to the unintended and unforeseen aftermath of the financial crisis and also out of desire to embrace the innovation enabled by technology. In all aspects, the tax department has to reflect and embrace the evolution of the business, while also incorporating tax specific developments. As similar drivers lead the change to both the business and the tax landscape more directly, the tax function may feel the impact of change with double the force.

First, we know tax compliance is more complex and we expect it will continue to become more intricate. The complexity is increasing as the business model changes, as organisations' global footprints expand and change, and tax reform, driven by governments' determination to boost revenues and close the tax net around international corporations, unfolds. We are also seeing developing countries become interested and engaged in the international tax landscape and may implement the recommendations of the BEPS project but are also contributing to the conversation we have. Companies can expect even more governments will be looking for its slice of tax revenue and have more resources to enforce collection. This means increased tax exposure and compliance burdens.

Second, an additional shift we are seeing is in the focus of tax policy makers from where capital is held to where activities are performed and products are sold ('substance'). This adds to the increase in complexity to determine what and where the 'substance' is and also the uncertainty in how tax liabilities will be determined as this is new paradigm. This will also increase tax disputes among jurisdictions which may define substance differently. This is especially true as the number of governments looking for a share of tax revenue expand. Many players are emerging into the conversation and have different views on what drives value.

Third, we continue to see an emphasis on transparency on the company but also on its customer and investor tax reporting. Increasing transparency with respect to global reporting is raising concerns to the C-suite level. This includes the reputational impact of making tax information available to a broader population of competitors. In response, the C-suite may create new key performance indicators and management reports relating to transparency. For example, the country-by-country reporting requirements will bring consolidated information and allow for a new lens at viewing the tax costs of business operations.

The growing complexity and increasing demand for transparency directly results in the need for more data, better data, and analysing and interpreting data faster. Again, technology and talent management will be key to achieving these goals. It also results in more risk and need for better risk management, and a type of risk management new to a tax team. The needs and role of the tax function today are vastly different than what they will be in 2020. We expect the tax function to shift from a primarily-labor intensive reporting and compliance function to a key enabler of a company's strategy.

Each company will have its own process, transformation roadmap and future state but we believe common themes will exist.

4

Conclusion

Assessing if your business is equipped with a tax function for the future

The changes impacting the tax world and the industry are universal. The drivers of change have been identified and the expectation of the function and responsibilities of a 2020 tax department has been described, but the future state and steps needed to change your tax department are unique.

Each organisation needs a transformation roadmap.

A transformation roadmap is a blueprint for change and should....

Develop a detailed plan with measurable objectives and timelines.

If it is not already, your 2020 tax department can be changed from a labour-intensive reporting and compliance function to a key enabler of the company's strategy.

We believe that the organisation of a typical tax team will be very different in 2020. The role of the tax department and the expectations for how the tax department delivers its service will both be different. Tax departments are facing new rules, new risks and new expectations.

The tax operations will shift from spreadsheet-based and disconnected from the main financial systems into a more technology driven function that is integrated – expect that almost all routine tax reporting and compliance will become automated. This automation is needed to meet the growing compliance burdens, enable companies to expand their businesses in many jurisdictions, to manage risk, but also become a baseline expectation.

Effective use of technology will free up tax professionals to provide a more value added and strategic role for the organisation and enter into an era where tax expertise has never been more critical. As this happens, do you have the right type and number of personnel in your tax department? Tax departments of 2020 needs to be able to leverage technology, processes and people in order to extract data in a tax-ready format. We believe most senior tax professionals know this but have run into barriers in transforming their tax function.

As your company redefines its business model, proactively responds to external pressures and reacts to global changes (such as the UK's vote to exit the EU) the use of tax department by the broader organisation will change. Have you started to consider possible future needs and what gaps your tax function may have?

It is impossible for the tax function to start the transformation process alone. It needs support from the broader organisation. The tax function will need to 'make its case' and be prepared to answer why and why now? This is not an easy task for a company in the banking and capital markets sector that is facing an endless array of demands. To meet this challenge, start now.

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