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Tax management was a term that was little used by companies until a few years ago. The tax director made his management aware of nasty surprises in his department or, preferably, dealt with anything before they developed that way. Other than that, what has now developed into a new practice area of its own, sometimes known as tax risk management, was just another part of a tax director's role, without any more significance than, for example, compliance or structuring.

Ralph Cunningham
Managing editor,
International Tax Review

Regulation has changed all that. Tax authorities are more and more aggressive around the world and having been doing their best to make sure that business managers can have no excuses for ignorance about their tax function. And other regulators, for example accounting standards organisations, with rules such as the Sarbanes-Oxley Act and FIN 48, have ensured that the relationship between tax has taken on an importance for the rest of the business that it may not have had.

It is in this context that *International Tax Review* co-publishes the second edition of its Tax Management in Companies guide with PricewaterhouseCoopers. The guide is the 44th in the Tax Reference Library series, which has also covered other topics such as transfer pricing, indirect taxes and outsourcing. They are designed to give in-house tax counsel the most cutting-edge advice for planning their corporation's tax strategy and structuring transactions in these fields. More are on the way.

As the following articles from PricewaterhouseCoopers show, there is a lot more to tax management in companies than making sure that the right amount of tax is paid on time in the places where it should be paid. Stakeholder communication, the role of technology and the structure of the tax function are other topics that contribute to effective tax management in companies.

We hope the insights these specialist tax advisers offer provide you with some valuable knowledge when dealing with the issues.

Coping with change

The world of corporate taxes is changing and there is no going back, says John Clymer

Tax executives have three options when it comes to changes: fight them, ignore them or embrace them. Most tax executives will spend some time fighting and ignoring before realising that in order to survive they must embrace change. Those companies that are not US registrants may not have experienced the full force of this wave of change yet, but macro trends have a way of spreading throughout the globe. Understanding the drivers of change may not be as interesting as what leading tax departments are planning to do about them.

Another Enron?

It's a story that has been heard many times. The rash of accounting scandals between 2001 and 2002 led to enormous bankruptcies, a crisis in the capital markets and ultimately intense regulations. In a few isolated cases, even tax employees were caught in the storm in ways that would have been difficult to imagine previously. However, rather than relive Enron and Sarbanes-Oxley, it can be concluded that these changes represent the early chapters of a story that continues today. But if Enron is the first chapter, then, in order to adequately appreciate what is really going on, there must be a prologue.

The good old days

To fully understand the whole story, it is necessary to go way back in time – before Enron. Although it was only seven years ago, it seems like ancient history today. At the time, the majority of tax departments were primarily focused on adding value to their companies. For some, this culminated in tax planning that was much too aggressive – although it may not have seemed so at the time. However, for most it meant that their energy was focused on managing cash taxes and earnings rather than operations. This lack of focus on operational issues is the true beginning of the story.

While many companies chose to invest in financial systems, the needs of the tax function within these companies were often overlooked and rarely considered. This left significant deficiencies in data access and quality. At the time, this was seen as no more than a major inconvenience. Investments in tax technology were limited and home-grown Excel spreadsheets were almost always the exclusive tools for tax provisions. Regardless, the concept of internal controls did not seem to apply to a tax department.

At about the same time that Enron was facing its fate, global tax authorities were focusing on attacking aggressive tax planning schemes. What was once widely regarded as acceptable practice became an embarrassment, a major liability or, in the most extreme cases, a criminal issue. This led to increased discussions about the role of tax in managing risk and enhancing community relationships – certainly not common discussion topics at tax conferences before that time.

In the old days, accounting for taxes was viewed differently as well. For example, if a tax department failed to perform the work necessary to compute and claim a tax credit, the resulting tax expense may have been a bit high but it was not necessarily a problem. If a study was pursued in a later year and significant refunds were obtained on amended returns, the benefit simply increased earnings in the year the refund was received and the tax executive emerged a hero. Apply the same to today's environment and the outcome is different. Instead of a hero, the tax executive may be singled out as the culprit who caused an embarrassing restatement to prior financial statements.

Tax balance sheet accounts were viewed differently in those days as well. One could easily argue that the primary focus was on the income statement. In fact, as long as the current income was stated properly, there was often quite a high threshold of materiality before a balance sheet adjustment was deemed necessary. Although not discussed in recent accounting literature, it is quite clear that Enron, Worldcom and other accounting scandals triggered an intense focus on the balance sheet. This shift of attention resulted in countless surprises when the tax balance sheet accounts were suddenly examined like they never had been before. Tax executives quickly learned that deferred tax accounts must now be supported by precise data rather than simply the cumulative sum of prior book/tax differences.

Accounting for uncertain tax positions was more of an art than a science back then as accounting literature and business practices left room for many different approaches to recording tax cushion. It is this renewed focus on the balance sheet that ultimately led to the painful adoption of FIN 48 for companies that were subject to US GAAP.

In summary, in the environment before Enron, senior tax executives had generally placed a greater priority on value and less on accounting, controls and efficiency. In other words, the vast majority of tax departments were totally unprepared for the pressures that they would soon face.

Embracing change

After all the changes brought forth over the last several years, many tax functions find themselves struggling to meet all of the demands imposed on their departments. A few examples of today's challenges include:

- primary focus on tax accounting rather than tax planning;
- resource shortages – especially tax accounting expertise;
- high overtime/low morale;
- poor internal controls;
- delayed closing processes;
- less collaboration within tax and with other business units;
- poor data quality and access;
- outdated technology; and
- inefficient processes.

Many tax executives continue to believe that if they ride out the storm everything will eventually improve. Others are beginning to realise that this tough situation may actually present a unique opportunity for their department to fix its problems. So what are these forward-thinking tax executives doing to embrace change? They are taking advantage of today's burning platform to push for a widened and strategic view of what must be done to truly fix their problems. This widened strategic outlook is best illustrated by the approach that many are taking when re-engineering their tax provision processes.

Tax accounting

Over the past few years, we have seen a huge increase in new tax technology vendors and applications – the most popular being the new tax provision tools that have hit the market. These applications are designed to replace the array of tax provision spreadsheets that exist in typical tax departments.

In most companies, tax provision spreadsheets began modestly, with functionality added on as the years progressed. Eventually these spreadsheets became so complicated that only their designers really understood the winding flow of calculations. A strange but effective analogy is to compare working with today's typical tax provision spreadsheet to your last visit to an old hospital. Within the hospital there may have been an original wing that was fairly simple to navigate: however, the original blueprint of the wing did not contemplate nor allow for easy expansion. Subsequently, over the years, new wings were added and countless improvements were made until no human being would be able to navigate their way through without endless signs to guide their way. Ultimately, only the people who work there every day know where they are going.

Tax provision spreadsheets are often loved by those who work with them on a daily basis. With plenty of time to perform the calculations, they generally work well. Their breakdown often occurs with unexpected last-minute accounting changes. With pressure to rerun the provision quickly, shortcuts are often taken which result in broken links or other computational errors. Because the spreadsheets are hard to follow, analytics cannot quickly detect the errors until much later in the process. This is a common cause of control deficiencies.

With all the shortcomings in tax provision spreadsheets, there remains an increasing demand for improvements in functionality, as well as reliability and controls. These demands have led to today's tax provision technology explosion. In fact, in the US, if a public company has not already implemented tax provision technology, the odds are very high that it is on their short-term agenda.

Unfortunately, many early adopters of the various technologies were disappointed when they failed to achieve the benefits that they originally promised. However, it was not that the tools were at fault. It was the fact that the scope of the implementation was confined entirely within the four

corners of the tax department, leaving the biggest data access and process challenges untouched. The same old painful processes were still necessary to gather the data needed to feed the new technology and an entirely new set of spreadsheets were necessary to replace the old tax provision spreadsheets that were retired. The end result was far from automated or efficient.

Today sees a trend towards taking a much more holistic view of tax operations rather than taking shortcuts that result in failure. Many leading companies are reaching the conclusion that their biggest obstacles to achieving operational improvements are data quality and access issues, and additionally the use of post-closing top-side journal entries. By addressing the configuration of enterprise resource planning (ERP) and consolidation software, as well as the chart of accounts and accounting practices, the data necessary to drive tax calculations can be extracted directly from financial systems to tax accounting technology without any manual intervention. In many companies, as much as 80% of the book or tax differences can be automated as well, which eliminates the need for most of the new spreadsheets that would have otherwise been necessary. In addition to improving accuracy, tax systems can be configured so that this same information will flow directly from the tax provision technology to tax compliance technology applications, resulting in greatly increased efficiencies.

The benefits of taking a holistic view of process and technology improvements go well beyond increased efficiency and accuracy. Because much of the time that is saved relates to the middle of the closing process, the preparation of the tax provision is streamlined, leaving plenty of time for analytics and little overtime. In addition, late changes may be rerun quickly without the added worries of broken spreadsheet links or human error.

Taking a holistic approach to the implementation of tax provision technology is only one example of a great opportunity to embrace change. The articles in this publication were written by many talented tax professionals from around the world, and they cover a myriad of topics which focus on people, process, technology, data, controls, strategy, structure and communications – all of the key enablers that drive today's tax function. Like the tax provision technology example above, the authors are able to illustrate how forward-thinking senior tax executives can address their challenges head-on by taking a very close look at every aspect of their tax departments. By embracing these challenges, senior tax executives can become the champions of positive change and avoid becoming the victims of disaster.

Biography

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John has been a US partner at PwC since 1993, is based in Boston, Massachusetts and serves as the global leader of PricewaterhouseCoopers' Tax Management and Accounting Service (TMAS) practice. TMAS focuses on all aspects of tax operations, from helping our clients improve every aspect of their internal operations to outsourcing critical core functions. By taking a holistic view of today's operational challenges, TMAS combines the power of PwC's Tax Function Effectiveness, Tax Accounting Services and Global Compliance Services networks to truly meet our clients' needs.

Applying corporate responsibility to tax

The practice of corporate responsibility is subject to much debate. Tax has a role not to be neglected in these discussions, say Urs Landolf and Susan Symons

A universal definition of corporate responsibility (CR) has yet to be discovered. However, it is widely accepted that it is about doing business responsibly, acting with integrity towards all stakeholders involved directly with the business (including customers, employees, suppliers and business partners). Corporate responsibility involves acknowledging and responding to the needs and concerns of others whose interests are affected by its operations (local communities, governments, society and the environment, for instance).

Corporate responsibility is about how a business takes into account the impact that its operations have on the economic, social and environmental fabric of society with a view to maximising the benefits and minimising the downsides that it perceives. These three elements are often referred to as the "triple bottom line" (John Elkington, *Towards the Sustainable Corporation: Win-Win Business Strategies for Sustainable Development*, 1994). Corporate responsibility or sustainability reporting is a process for publicly disclosing an organisation's economic, environmental and social management and performance.

Many companies find that financial reporting alone no longer satisfies the needs of the various stakeholders that have an interest in it. These stakeholders will include shareholders, customers, investors, government and the community at large. Organisations disclose how they manage risks through CR reporting, such as how they handle hazardous waste, minimise negative impacts such as the emissions of greenhouse gases and embed values and principles. An example for the latter is requiring suppliers to meet certain standards of employment and create value through good human capital management.

How does corporate responsibility apply to tax?

Many organisations have given a great deal of thought to their CR in relation to social and environmental issues. The economic dimension has arguably been the least developed and it is often equated to financial performance. However, although related, the financial and economic elements are not equivalent. The financial element focuses on the market value of transactions and how they pass through the accounts, while the economic element takes a wider perspective, extending beyond the boundaries of the organisation.

Paying tax is considered to be an important part of a company's economic impact and contribution to society, as taxes fund social investment. But a call for a CR agenda on tax is not simply a call for companies to pay more tax. It is about applying the relevant principles of CR. These include:

- accountability;
- transparency and disclosure;
- engagement with stakeholders;

- an ethical approach;
- a commitment to add economic value; and
- setting an appropriate tax strategy.

Is tax more than a legal concept?

Companies may choose to deal with their tax issues within the letter of the law to reduce their tax burden. The judgment of Lord Tomlin (in *IRC v Duke of Westminster*) underpins this: "Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it would be otherwise."

However, some stakeholders take the view that reducing a company's tax burden by simply applying the letter of the law is not enough in terms of their CR to the society in which the company operates. Some believe that companies should also observe and apply the spirit of the law when dealing with their tax issues. They should view tax not merely as a cost to the business but as a contribution to society and its infrastructure – in essence, a fee paid to society for the right to operate within it.

This implies that tax is not simply a legal concept but that there are ethical values that can and should be considered when considering and setting a company's tax strategy. Values such as integrity, fairness, respect and openness are all relevant when setting a tax strategy and taking commercial decisions.

Alignment of tax strategy to general business principles

Corporate responsibility concepts increasingly have relevance in the day-to-day running of a business, and many businesses consider CR principles in setting their overall business strategy. To date this has certainly been the case in the area of supply chain management with the emergence of fair-trade principles, even if this has perhaps been for the basic commercial policy objective of minimising damage to reputation or to enhance a brand.

Increasingly, such concepts are being applied to tax, particularly as a growing number of stakeholders are taking an interest in tax. The diagram below gives a good indication of the interested parties and the sorts of issues that they wish to address. In many jurisdictions, tax is being pushed up the corporate responsibility agenda by government and is playing a more significant role in the economic element of their triple bottom line.

The practical approach to tax and CR is therefore to align a company's tax strategy with the wide-reaching business strategy.

Tax planning and CR

Historically, the determination of what can be defined as acceptable tax planning has referred back to the concepts of tax evasion and tax avoidance.

Diagram 1: Stakeholders and what they are interested in

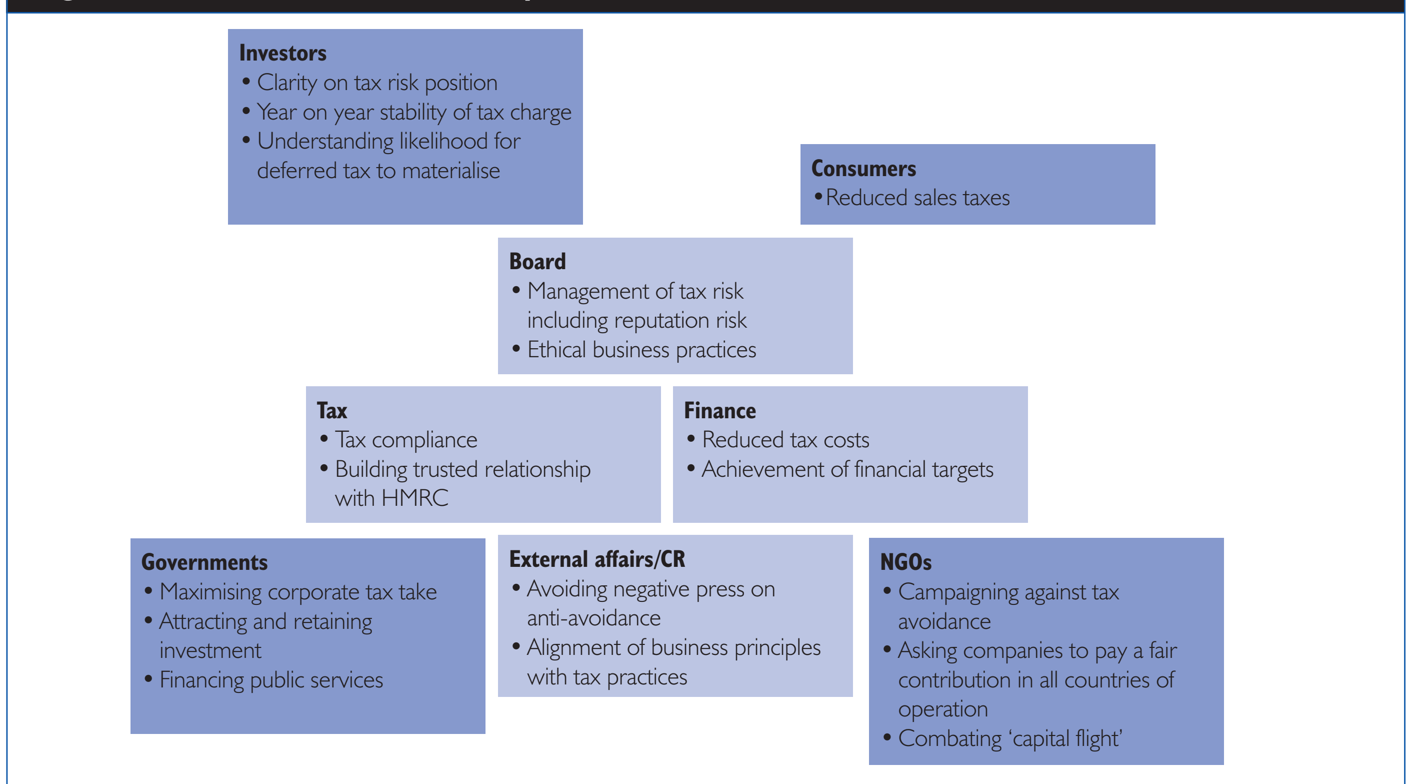


Diagram 2: Categorisation of tax planning

Tax evasion and tax avoidance are widely recognised and used terms. While both are concerned with the reduction of a tax liability, evasion is illegal whereas avoidance is legal. Evasion typically involves suppression, concealment or misreporting; avoidance involves using the provisions in the tax code. The difference between the two terms was encapsulated by former UK Chancellor of the Exchequer Denis Healey as being "the thickness of a prison wall".

Therefore, the distinction between the two is not the extent to which planning is undertaken but of the kind of activity that is engaged in.

Lord Clyde said in the case of *Ayrshire Motor Services* and *Ritchie v CIR* in 1929 that "No man in this country is under the least obligation, moral or otherwise, so as to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his store."

Under this and similar doctrines tax planning is permissible. Indeed it can be said that tax planning is legitimate in most countries because the law offers the potential for economic transactions to be structured in a number of different ways. Ultimately, business has an obligation to pay the amount of tax that is due under the law of the country in which it operates, and in accordance with the law.

However, with the increasing interest in tax from other stakeholders, rightly or wrongly the public perception of what is considered acceptable tax planning has been changing. A phrase much used in recent years in this respect is that companies should pay "a fair amount of tax". So although in theory the distinction between what is acceptable and what is not is absolute, it would also appear that there are clear lines as to what is legal and what is not, and the distinction between tax avoidance and tax evasion. In reality the boundaries have become blurred. This – the blurring of the boundaries – can in part be attributed to interested stakeholders considering tax issues from a CR perspective. The diagram above shows one way of expressing the spectrum of categorisations that exist. This was developed by Lord Templeman, a noted and now retired law lord in the UK, in a Privy Council case (*CIR v Challenge Corporation Ltd*).

In arriving at a responsible tax strategy, the board of the company will need to have considered and have a perspective on how the business views the fair or proper amount of taxes that tax authorities and other stakeholders expect. The starting point may be to think about where the organisation sits or should sit on the scale in diagram 3, where the higher the score the less you are concerned with CR in relation to tax.

Information to help with disclosures around CR

In order for the board to properly address the CR issues that relate to tax and the tax strategy for their organisation, it will need to have access to information on all the taxes that the company bears and collects. It will also need to have some insight as to how this compares with other organisations of similar size or those that operate in the same industry sector. To assist with this need, PricewaterhouseCoopers (PwC) developed the Total Tax Contribution (TTC) framework.

The PwC TTC framework

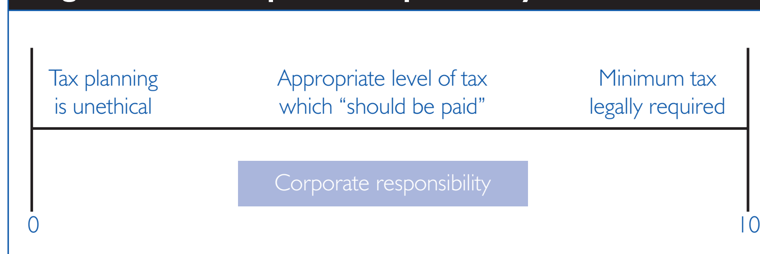
The TTC framework enables tax information to be gathered under a consistent methodology to facilitate an improved understanding of the tax position of the company and ultimately to help with the reporting and communication of tax data. This provides a good foundation from which companies can respond to the increasing expectation of transparency around tax matters. Not only does the framework take into account corporate income tax, it also takes into account all of the business taxes borne or collected by a company, in order to determine a company's total tax contribution to public finances.

The PwC TTC framework has two fundamental points of principle. The first is to define what a tax is. It is important to be clear as to what kind of payments actually constitute a tax. Some payments, such as corporate income tax, employee tax (PAYE) and VAT are obvious. The categorisation of some other payments is perhaps less clear-cut.

As a starting point, a tax can be defined as something that is:

- paid to the government;
- compulsory;
- used by the authority as part of the public finances; and

Diagram 3: Tax corporate responsibility scale



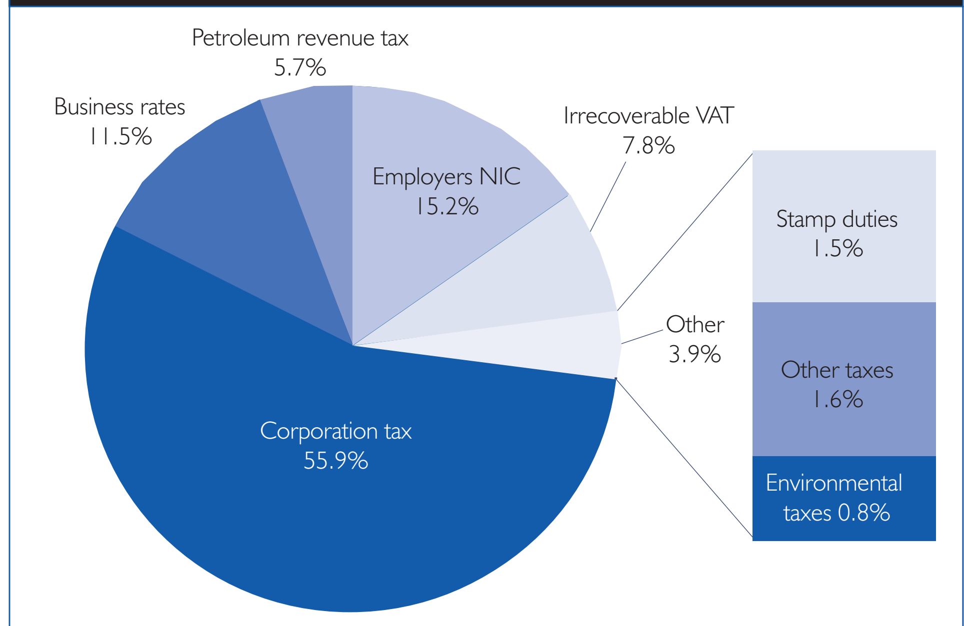
- with no direct return of value to the payer.

These basic principles are in line with the OECD definition of a tax.

The second is to draw a fundamental distinction between business taxes borne by a company (the company's own tax contribution, which constitutes a cost to the company) and taxes collected by the company (where the cost of the collection, and not the tax itself, is a cost to the company). It is important to recognise and include the taxes collected by a company as these demonstrate the role that the corporate sector performs as unpaid tax collectors for government. The compliance cost to companies for performing this service can be a significant aspect of the regulatory burden.

Multinational companies that operate across a number of countries will need to look at the TTC in a number of jurisdictions with different legal frameworks and compliance requirements. The contribution will be substantial.

Diagram 4: Percentage of taxes borne by participants in the 2007 survey of The Hundred Group in the UK



Measuring the taxes paid and collected in practice

The TTC framework is being used to assist companies on two levels: from an internal tax management perspective and also externally in terms of its ability to communicate with a diverse array of stakeholders.

From an internal perspective the framework helps companies to gain an understanding of the impact of all of the taxes on their business. It is usually the case that tax departments are focused on those taxes that get most prominence in the financial statements; they are often not well informed as regards all of the other taxes borne or collected by the company. In the UK, for example, business rates – a tax based on the value of a corporate's business property that is collected by local councils (local governments) – is often an important tax that can be substantial but that is not administered or controlled by the tax department. It is therefore unlikely to feature when looking at the tax strategy of the business.

The TTC framework seeks to provide data and therefore visibility on the impact of all taxes on the business. The framework also provides the ability to benchmark these various taxes paid by a company against other companies, perhaps against companies in the same industry sector, so that useful comparisons can be made.

From an external perspective, the TTC framework provides data to accommodate increasing demands for companies to develop and disclose tax policy and strategy to satisfy growing stakeholder scrutiny.

The TTC provides the data to help companies engage (individually or perhaps as members of a trade association) in positive dialogue with governments and other stakeholders, to develop or improve a shared understanding of the total tax contribution made and so inform discussion that will help policy formers shape the tax system in the future. Companies and governments share some common goals, including the provision of an economic environment that helps businesses to grow, enabling them to be profitable and thus to employ people. One consequence will be to generate taxes in all of their various guises, thus offering the potential to contribute to a stable social fabric and an infrastructure that is conducive to sustaining the growth of business and improving the standard of living for the nation as a whole. The sort of work that PwC has undertaken with this external perspective in mind can be illustrated by the annual survey with The Hundred Group in the UK. This has now been successfully run for three years and a fourth year of results is due for release next year. One of the key messages from this work is that corporate income tax is only just more than half of the story. There are four other key business taxes borne by the Group's members and another 17 that can affect them, all underlining the complexity of the UK system.

There has been an active engagement with government using the information generated and The Hundred Group has made good use of it in promoting the message that business is looking for government to provide a clear, stable policy framework that can give business the certainty it needs to plan ahead.

Increasingly, the data generated by the framework is also being cut in different ways to illustrate the size of the contribution made by business, the importance of the workforce,

the employment taxes generated, the value created by business and who receives it. The data generated through the TTC helps form the wider economic footprint of companies.

Similar work to that undertaken with The Hundred Group in the UK has been commissioned in other countries. Australia, Belgium, South Africa and Canada have published reports and France, Germany, India, Ireland, Luxembourg and the US are due to follow suit later this year and early next year. These will all add further data to inform the debate on the international competitiveness of tax systems around the world. They will also give additional insights to the tax compliance burdens and the total tax contributions made on an international scale.

What else will help in the future?

The environment around tax is increasingly subject to change. Historically, tax has been perceived as a technical subject of limited interest to most stakeholder groups. However, as mentioned, the environment is increasing its demands, through a more diverse set of stakeholders, for more information on tax. These stakeholders have a need to understand what a company's tax strategy is and how that strategy is managed by the board and executive management. Understanding a company's tax strategy and objectives is a key first step to understanding how a company approaches tax, its attitude to planning and tax compliance and the way it balances the pressures of minimising taxes to enhance shareholder returns while managing risks to its reputation.

In addition, stakeholders want to understand the impact of the company's taxes on its business and on the community. Particularly, they want to know how tax impacts the business strategy of the organisation, how tax impacts shareholder value and the impact of taxes paid by companies as part of their economic contribution to the communities in which they operate.

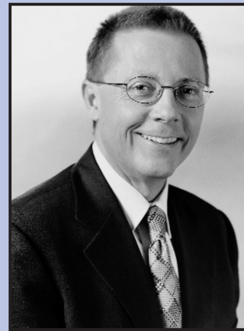
A company's response to these demands and its ability to adapt to the changing tax environment is fundamental to its ability to manage its risk to reputation. Transparency is a key factor.

Stakeholders want detailed information about the taxes paid by the company, the company's tax strategy and how that strategy is managed by the board and the executive management. The diagram on this page summarises what each of the main categories of stakeholder is looking for; this can be assisted by increasing effective disclosure and communication.

The tax transparency framework

From discussions with different stakeholders, PwC has developed a tax transparency framework (see a discussion paper published by PwC in November 2007) to assist in meeting these demands. This framework suggests nine aspects, grouped into three areas, on which companies can consider providing information. These are summarised in the table on the next page.

Biography



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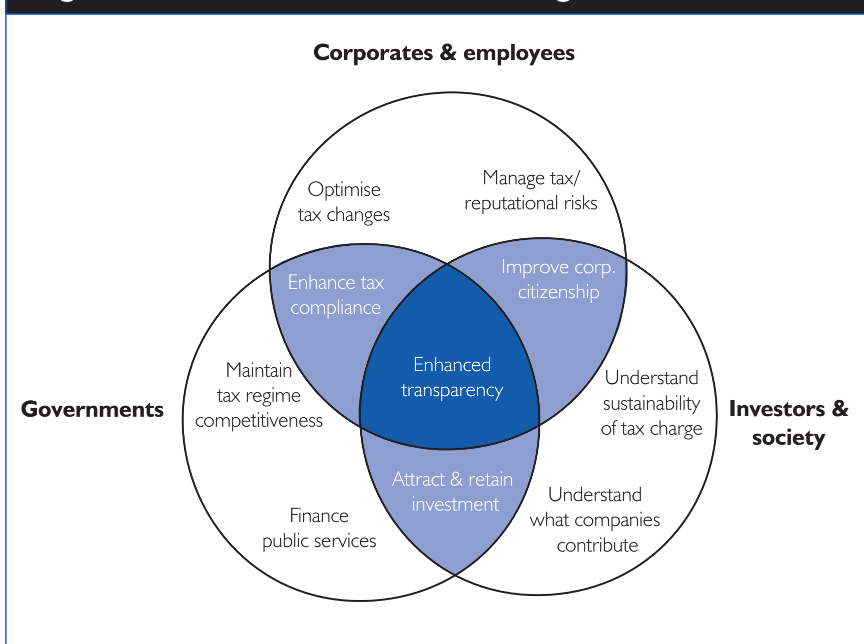
Urs Landolf is the leader of the PricewaterhouseCoopers' tax and legal services practice in Europe, Middle East and Africa. He is also a member of the global leadership team of the tax and legal services practice. He joined the Swiss firm in 1982 and became a partner in 1988. He is a specialist in international tax planning for multinational corporations including structuring of transactions and reorganisations, and of value chain enhancements. He also advises entrepreneurs and owners of private businesses. He is a frequent speaker at conferences and author of articles on the above mentioned subjects. Landolf graduated in business administration and eonomics and obtained his doctor in law both at the University of St Gallen.

Diagram 5: What stakeholders are looking for



PricewaterhouseCoopers has used this framework to assess how the standards of communication around tax transparency have changed in recent years as part of the UK firm's Building Public Trust Awards (BPTA). In doing so, the firm has been able to identify some good examples of companies that are leading the way in this arena. It is evident that there has been a noticeable improvement in the quantity and quality of tax information provided by companies over the last couple of years and that there is an expectation that the rate of change will increase.

Vodafone won the 2007 BPTA award for tax reporting and provided a good example in its 2007 corporate responsibility report of disclosures around tax strategy, objectives and attitude to tax planning. The Unilever 2007 accounts show what can be done to fully explain how the effective tax rate reconciles to a blended statutory rate in the countries in which they operate.

Anglo American includes a substantial note in their Report to Society in 2006 that explains the many taxes paid beyond corporate income tax and shows the split between taxes borne and taxes collected. Excerpts from these companies' reports can be found at the end of this article.

Outlook

Looking forward, communication around tax will be an increasing area of focus. It is very high on the boardroom agenda, and governments and tax authorities are keen to see it there. Significant events such as the collapse of Enron, the changing attitudes of tax authorities and the increased focus by the investment community have all contributed to this change in attitude and emphasis. This has undoubtedly increased the focus on the CR agenda and has ensured that tax is part of that agenda. Aligning the tax strategy with the overall business strategy set by the board, having complete and relevant data to inform the setting of that strategy and to inform dialogue with government, and having the right tools available to help with the communication around tax and tax strategy to all interested stakeholders are all key to ensuring that CR and tax are properly addressed.

Biography

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Susan Symons is a senior tax partner with PricewaterhouseCoopers, based in London, and leads the firm's team developing the Total Tax Contribution framework to enable companies to understand and report on their contribution in business taxes. She leads the engagement with The Hundred Group to annually survey and report on their UK Total Tax Contribution and is the co-author of the PricewaterhouseCoopers/World Bank Group publication "Paying taxes – the global picture" which compares the ease of paying taxes in 181 economies worldwide. She also runs PricewaterhouseCoopers' heads of development programme for the tax directors of the largest companies doing business in the UK.

Table 1: The PwC tax transparency framework

- Tax strategy and risk management
  - A clear discussion of the company's tax strategy and objectives;
  - Full details of how the company's tax strategy and function is managed and who in the organisation has responsibility for governance and over sight;
  - Clear disclosure of the material tax risks faced by the company.
- Tax numbers and performance
  - A clear explanation as to why the current tax charge is not equivalent to the accounting profit at the statutory rate of tax;
  - A transparent reconciliation of the company's cash tax payments to the tax charge included in the income statement;
  - Disclosure of forward looking measures for tax, including forecast accounting and cash tax rate.
- TTC and the wider impact of taxes
  - Detail as to how tax impacts the wider business strategy and results of the company;
  - Disclosure of the impact of tax on shareholder value;
  - Clear communication of the economic contribution of all taxes paid by the company.

Vodafone

Vodafone paid £2.5 billion in taxes across the countries in which it operates in the 2007 financial year. We believe it is important to state clearly and precisely our views on tax in the context of corporate responsibility.

We operate within a clearly defined Group Tax Code of Conduct. This sets out the principles, responsibilities, conduct and approach to working relationships of all tax professionals working in (and with) Vodafone.

We believe our obligation is to pay the amount of tax legally due and to observe all applicable rules and regulations in all of the territories in which we operate. At the same time, we have an obligation to maximise

shareholder value and to manage financial and reputational risk. This includes minimising and controlling our tax costs. We accept that some may not share this view and believe that transparency regarding our position is the best policy.

Vodafone's Group Tax Code of Conduct requires its employees and advisors to act with integrity and maintain the highest ethical standards in all of its tax activities. Vodafone does not condone tax evasion (using illegal means to reduce taxes payable) in any circumstances.

We are committed to transparent and accessible communication to enable others to understand our tax strategy and the economic impact of taxation on our business. Vodafone was highly commended by the 2006 Building Public Trust Awards for its tax reporting in its Group Annual Report for the year ended 31 March 2006.

We aim to build open and honest relationships in our day-to-day interaction with tax authorities. In the UK, for example, Vodafone is participating in an initiative launched by Her Majesty's Revenue & Customs to build relationships with big companies both at an operational and strategic level. Nonetheless we recognise that there may be some areas that are not free from doubt or where differing legal interpretations may be possible. Consequently, situations arise from time to time where tax authorities may not share our views and may question our interpretations.

Vodafone Group plc, Corporate Responsibility Report, March 31 2007, page 31.

Unilever

Europe is considered to be Unilever's domestic tax base. The reconciliation between the computed weighted average rate of income tax expense, which is generally applicable to Unilever's European companies, and the actual rate of taxation charged is as follows:

Table 2

Reconciliation of effective tax rate	% 2007	% 2006	% 2005
Computed rate of tax(b)	27	30	31
Differences due to:			
Other rates applicable to non-European countries	2	1	–
Incentive tax credits	(6)	(7)	(5)
Withholding tax on dividends	2	1	2
Adjustments to previous years	(5)	(4)	(2)
Expenses not deductible for tax purposes	2	2	2
Utilisation of previously unrecognised tax losses	–	–	(1)
Other	–	1	(1)
Effective tax rate	22	24	26

(b) The computed tax rate used is the average of the standard rate of tax applicable in the European countries in which Unilever operates, weighted by the amount of profit before taxation generated in each of those countries.

Unilever annual report, 31 December 2007, pg 83

Anglo American

Sustainable societies need strong foundations – built on law and order, health, housing and education, infrastructure, communications and a well-protected biophysical environment. All of this takes money, which is usually derived from companies and individuals in the form of taxes and is, ideally, redistributed for the benefit of the whole society.

The taxes we pay as a company and those we collect from employees on behalf of government are, therefore, important contributions to the creation of wealth and wellbeing in the countries in which we operate. We fully endorse the principle of transparency in our business dealings and we are signatories to the EITI. This UK-sponsored initiative encourages the reporting of taxes and monies paid by companies active in the extractive industries and by countries receiving revenues from the extractive industries.

Over $3.1 billion was paid directly to governments in taxes as a result of our operations in 2006 ($2.1 billion in 2005) – the increase is a result of both increased revenues and improved reporting. Total tax payments include company taxes, employer taxes, royalties, transaction and other taxes, with the broad aggregates, split on a regional basis, as shown in the table.

In addition, we indirectly contributed some $1.3 billion in valued-added tax (VAT) and employee taxes, which we collected on behalf of governments and paid over to them. We believe that this wider tax footprint is a valid reflection of the tax contribution that results from our activities. In many developing countries this is a particular concern as, in the absence of our operations, there would be few alternative sources of income and therefore of tax revenues.

Anglo American Report to Society 2006, pages 13 and 14

Table 3

Taxes paid directly to governments by country* — **$ million**

	Borne	Collected	Total
South Africa	1, 034	551	1,585
Chile	1, 032	10	1,042
United Kingdom	235	325	560
Australia	234	57	291
Austria	48	90	138
Brazil	85	48	133
Russia	83	20	103
France	44	39	83
Venezuela	77	1	78
Canada	5	56	61
Poland	46	14	60
Others	196	125	321
Total	3,119	1,336	4,455

* Unaudited amounts of taxes payable directly to governments as a result of our opperations (borne) and amounts collected and remitted to governments, such as employee taxes and net value-added tax (collected).

Taxes paid directly to governments by category and region — **$ million**

	Africa	Europe	N&S America	Australia/Asia	Total
Profits	948	178	1,140	91	2,357
Transactions	28	35	13	0	76
Labour	30	172	24	39	265
Royalties and environment	55	136	32	89	312
Other	23	61	10	15	109
Total taxes borne	1,084	582	1,219	234	3,119
Taxes collected and remitted	562	596	121	57	1,336
Total taxes	1,646	1,178	1,340	291	4,455

Anglo American Report to Society 2006, pgs 13 and 14

The great crossover

Rüdiger Loitz, Tobias Taetzner and Tom Weber explain how finance can help improve tax effectiveness

Today's regulatory environment forces tax functions to deal with multiple challenges and tasks. The traditional role of a tax function in relation to a financial function – such as offering qualified tax advice covering tax issues, managing local compliance matters and defending technical positions during a tax audit – has been replaced by increasingly complex rules.

The tax function's new role is based on contributing value to the company's overall strategy as an integral part of the business. In this environment, tax processes are very much relying on the huge amount of information provided by the finance function. On the other hand, quality tax data is part of the reporting cycle to produce accurate financial information. Unsurprisingly, finance and tax processes are highly interdependent. As such, they surely deserve a look at the way in which they can effectively operate their day-to-day working activities.

In this context, process improvement serves as a means of managing the time, cost, risk and quality of the underlying tax process. It provides a good opportunity to review the efficiency of tax processes. This is especially the case when the business is short of qualified tax staff. Significant weaknesses have revealed themselves in the operations of a fundamental tax process.

It could be useful when analysing your processing of tax and finance if you ask yourself the following questions.

- Are you always involved in material accounting or finance decisions?
- Did any issues come up during the preparation of the financial statements because of a lack of interaction between tax and finance?
- Did you always have an overview about the fluctuation of your tax rates?
- Have you, in any transaction with consequences for accounting, always thought about the consequences for the taxes and the tax rate of the group?
- Were there any decisions about accounting (goodwill impairment, pensions or financial investments) you were not involved in?

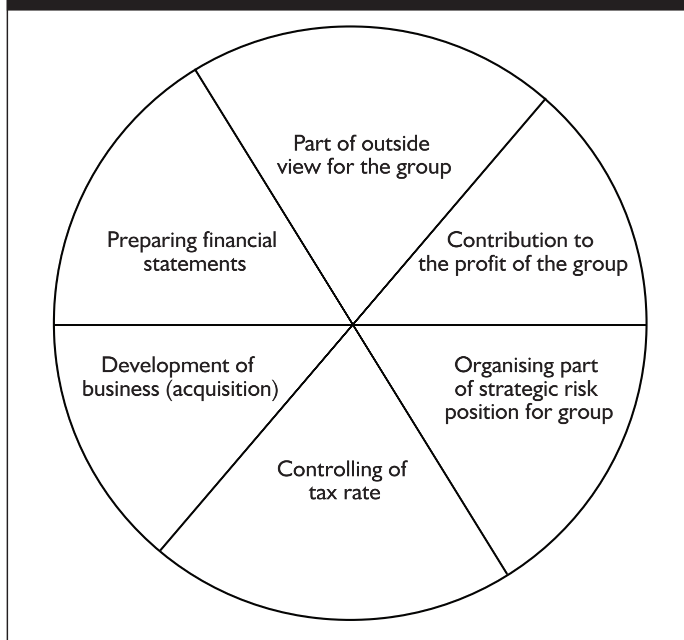
The following explanations should give an overview of what could and should be done to come to a best practice approach for the work between tax and finance.

Tax trends and finance issues

Traditionally, the tax function has been in charge of providing technical tax expertise for a wide range of tax issues. For the finance function, tax was only an adviser in special situations. The day-to-day accounting and reporting functions were carried out by finance. However, the primary task tended to focus on the local operating integrity of tax compliance; data was extracted and analysed only locally to fulfil tax declaration and filing responsibilities. Its function was mainly technically orientated, leaving little room for involvement in strategic business decisions.

Tax processes within the company's organisation were an issue not discussed even

Diagram 1: Role of finance function



for the finance function, which is often very closely related (tax adjustments must be booked, for instance). Interdependencies between the tax function and finance were not even an item on most companies' agendas when it came to process improvement.

Changes in their operating environment made multinational companies rethink their approaches and led to a modification in the design of tasks for the financial and tax functions on the basis of an integrated approach. Responsibility for the tax position in the published financial statements, and therefore tax reporting for the whole group, has been shifted to the group tax function, which now requires increased transparency and improved internal controls and documentation.

Simultaneously, international developments established a need for international tax strategies: capital markets expect a company to present their global tax situation from a benefit-cost-perspective. Increasingly, these developments have led to benchmarking the effective group tax rate. The group tax rate depends on two figures: income taxes and financial results. Accordingly, the interaction of tax and finance is required.

The demands for a new tax function have never been more self-evident than today:

- generating profit by generating tax-driven business strategies;
- playing a key role in preparing the financial statements for the group;
- being part of the general picture visible to other companies;
- helping the group to develop business;
- controlling the tax rate on a centralised basis, considering fluctuations of tax rates of other peer group companies; and
- creating the risk profile for the whole group.

A global approach to the interaction between tax and finance processes forms the basis for improvement. At the end of the

Table 1: Input of tax function

Work flows	Examples of key processes	Potential for optimisation	Value to the business
Deferred tax calculation	• Comparison IFRS - tax bases • Evaluating tax losses carried forward	• Authorisation • Increase time for special issues	• Reliable future tax effects in the accounting
Current tax calculation	• Organisation fast close • Organisation outcome of tax audits	• Smart Close instead of Fast Close • Security for coming tax risks in the accounts	• Reduced surprises after year end
Acquisition or disposal of companies	• Standardisation of documentation • Proposition for decisions • Organise tax involvement	• Reliable processes • Increased effectiveness of processes	• Quality for propositions increased
Preparing notes for financial statements	• Identifying tax relevant rates • Consistency checks	• Integration in preparation of finance departments	• Quality of tax notes increased
Organisation of financial funding	• Placing bonds, loans • Organisation of international financing • Finale of acquisitions	• Reorganising processes covering tax effects	• Effectiveness of financial decisions increased

day, the final goal of process improvement should offer an answer to where the tax and finance functions want to position themselves strategically, how confidence in the efficiency of its processes can be increased and how finance, together with tax, can take a leading role. As a result, the mix of clearly defined responsibilities and reporting tasks, increased specialisation and the use of service centres and external advisers can give a organisation the competitive edge.

Workflow for interaction between tax and finance

The interaction between tax and finance is key to optimising processes. It is a collection of interrelated workflows. Workflows typically range from strategic processes to operational and technical advice.

The status of optimising processes with the help of finance

Process ownership

When it comes to process improvement regarding tax processes, a key issue is the answer to the following question: who is responsible for tax deliverables around the tax process?

Issues arise when responsibilities between finance and tax are not clearly defined and communication and reporting between the interdependent functions have not been properly taken care of. For example, during a process improvement initiative for a client we observed that the tax department was increasingly involved in the evaluation of financing and cash pooling structures. These transactions also required an in-depth practical knowledge of accounting for financial instruments. The responsible tax specialists did not have the required expertise for this area, while the finance department could offer qualified advice but was not aware of the problems arising from a tax perspective.

Quality of data and use of systems

Tax processes rely to a great extent on the quality of data and information (pre-tax figures) delivered by finance and within finance by accounting. Usually, no integrated system is in place that can be used for all purposes and by all users of the data. Moreover, differing accounting systems in different geographic regions and additional acquisitions aggravate the process of producing, retrieving and using data consistently among the systems. Finance can help set up integrated systems where tax is involved.

Under the existing circumstances, tax personnel are more concerned about the accuracy and validity of the collected data than actually finding out whether the figures make sense. Automation potentials cannot be used efficiently, as too much work has to be done manually.

Centralisation of tax and finance function

Within the finance groups of companies we see an increase in centralised reporting lines. The head of finance is responsible for all accounting areas in the world of the company. This means that the finance manager in China reports (directly) to the head of finance at corporate headquarters. Tax groups still hesitate to reorganise, becoming aware that the tax function is not the same in the new world and taking additional responsibilities and risks besides reorganisation. However, tax reporting lines should be reorganised in a very similar and strict way by optimising the performance between finance and tax.

Biography

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Rüdiger Loitz joined PricewaterhouseCoopers 11 years ago and is the lead partner of the German-wide tax accounting & reporting group as well as the umbrella partner of the German tax management and accounting services, which include global compliance, tax accounting and tax function effectiveness solutions. The key focus of his work centres on accounting for income taxes in accordance with international accounting principles. He has profound knowledge and experience of tax management and accounting services from numerous conversion and tax audit engagements with SEC and DAX listed clients. Furthermore, he gained international experience from various services in the US, the UK and Spain.

Time

As tax functions are increasingly involved in the year-end or quarterly financial statements processes, a typical challenge for them is to get the balance right between time spent on large tasks (tax accounting and reporting, for example) and other issues such as tax planning or tax strategies. Demanding a fast close while managing other issues only puts additional pressure on staff when their workload is not reduced (by outsourcing tasks to finance where only moderate or lesser involvement of the tax function exists, for example). Where implementing hard closes for tax could help, finance should assist.

Cost of resources

The essential cost driver for today's tax functions is the cost of resources. Qualified tax specialists are a scarce resource. The complexity of major tasks usually requires a great deal of technical expertise, particularly in specialised areas such

Biography

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Tobias Taetzner is a partner in the Frankfurt corporate tax practice. After studying business economics, he joined PricewaterhouseCoopers in 1995. He became a certified tax consultant and graduated as a PhD in 1999. He then became a chartered accountant (German CPA) in 2000. He focuses on tax function effectiveness and international tax structuring. He works on behalf of many international corporations that are either domiciled in Germany or which have subsidiaries there. Taetzner lectures on tax at Frankfurt University and has written several essays and books.

Biography

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Tom Weber is a partner in PricewaterhouseCoopers' advisory finance & accounting practice and has more than 14 years of consulting experience in the area of management reporting, finance process improvement and tax function effectiveness. He has led a number of tax function effectiveness projects with national and international clients. He builds on his process improvement expertise in finance and reporting processes to also optimise processes and systems at the interface of financial and tax accounting. Furthermore, he has gained experience with redesigning the tax organisation after mergers and internal restructurings.

as tax accounting. Unfortunately, from our experience, tax personnel are often too busy focusing on issues. Moving from tax to finance and vice versa should help to increase knowledge.

Awareness of the varying stakeholders and their specific interests and needs

Today's world of numerous tax functions is heterogeneous and complex. External stakeholders such as banks, financial analysts and investors require different information than internal stakeholders such as management. In addition, due to the sensitivity of data, the preparation of information for tax authorities requires a different mindset than the due diligence of a potential merger. As a result, the same set of numbers needs to be addressed from different perspectives and for different purposes. Finance should help the tax function to think from the point of view of external users; finance is more experienced than tax.

Recommendations

If we have identified the processes and issues that offer potential for project improvement in your group through an integration with the finance function, it is time to define the goals for this venture. The following goals could be part of a project.

Optimisation of technical expertise and know-how

Enabling people to combine and share knowledge on a cross-functional basis between tax and finance should be part of process improvement. We can assist in developing concepts for training and exchanges between departments, as well as building new departments and groups to optimise the use of resources.

Increasing process reliability, reducing process complexity

An integrated quality review system that does not ignore interdependencies between tax and finance and simultaneously complies with regulatory requirements should be a good starting point. Simplifying processes through standardised information flow between both functions could minimise additional failure and error potential. We can assist with best practice workflows and help you to change your organisation to best practice.

Time efficiency and improved adherence to due dates

One significant constraint is the time dedicated to multiple tasks. A formalised process approach should include a project plan timeline or calendar that specifies the due dates for different deliverables between the tax and finance functions. We can moderate the process to change the integrated tax and finance processes to increase efficiency when working to strict deadlines.

Automated systems

The advantage of developing an integrated system that provides data from many different sources and that can be used for many different purposes is obvious. In this respect, such a system can reduce the need for manual intervention by automated processes. We can help to clarify which processes offer potential for automation. We can then assist in implementing automated systems, rolling the new processes out across the system.

Gaining control

Tax risk management, tax accounting and being "in control" have been on the agenda of most tax departments in the recent past, say **Eelco van der Enden** and **Robert van der Laan**

In trying to find a solution for tax risk management, tax accounting and being "in control", we see companies working towards an integrated tax control framework (TCF), a tax risk management and control environment embedded in the internal control framework (or business control framework). We see companies describing tax processes, which are essential to taking control and developing and implementing tax accounting manuals and sustainable IT platforms for tax. But processes are designed, operated, managed and monitored by people. Accounting guidelines need to be understood by people. Information technology systems should serve the people, not the other way around.

A practical problem is that qualified staff with sufficient tax knowledge and experience in managing tax is a rare and expensive commodity. This is, of course, no problem if you have an unlimited budget. Alas, that is not often the case. If we accept the above as a fact we will understand that the tax department cannot manage tax by itself. So we need to fall back on people within the organisation who usually have no tax background. If people who have to deal with tax processes do not understand or want to understand the what, why and how of managing tax, new processes will not bring the desired results, because of resistance to change.

The tax department needs to create synergies and forge dominant coalitions with various people within departments of the head office and all relevant offices over the world in order to be able to manage tax processes. If we want to change people's behaviour, we need to communicate in an understandable way. For example, communicating with the tax department, (local) controllers, salespeople, treasury managers or internal auditors all require a different approach. Why? They all speak a different language, technically speaking, although this often is the case literally. If we want to change behaviour, we must understand what drives people.

An integration process is not ready just because the chief executive officer says so. A reorganisation is not finished when the chief financial officer claims that the reorganisation is finished. An IT project is not ready when the software is integrated into the existing enterprise resource planning (ERP) environment. In all three examples the projects are ready if the people involved have changed their behaviour in such a way that the set objectives have become the common objective and the desired results are realised. The same applies to tax.

The company is not in control of the tax function because the tax department says it is in control. What matters is what the perception of the stakeholders is; this is about facts. Do people outside the tax department understand what they must do? Will they achieve the desired results? In our view, in the tax environment, the people aspect of managing change has not received the attention it deserves in the discussion surrounding tax control.

Changing the landscape and the need for control

Most tax departments are part of the financial staff in any typical organisation. For example, the department is responsible for the effective tax rate and possibly the requirements for transfer pricing and supporting the business.

The people in the tax department must respond to any urgent questions they receive from other staff departments or business units. What frustrates tax departments immensely is: "why aren't they involving us from the start, instead of asking whether something has tax consequences at the end of the process?" This is a relevant question that also bothers other staff departments: Human resources and risk management for instance, to name two obvious ones. Another cause for frustration is: "why do tax data always come late and why is the quality often so poor?" As a consequence, the tax department is deemed not to be in control. How can we solve this issue of being informed after the event and deliver value by being informed upfront and not after the event? How can we ensure timely and quality reporting? We can achieve these objectives and increase control if we can change the behaviour of the people involved.

Companies' response

A not uncommon reflex during discussions around the tax control issue is the tax department denying it is not in control. This reflex is often caused by fear of being fired or having a difficult discussion with the CFO. We also see the interpretation of the term "in control" differing between the tax department and, for example, internal or external auditors.

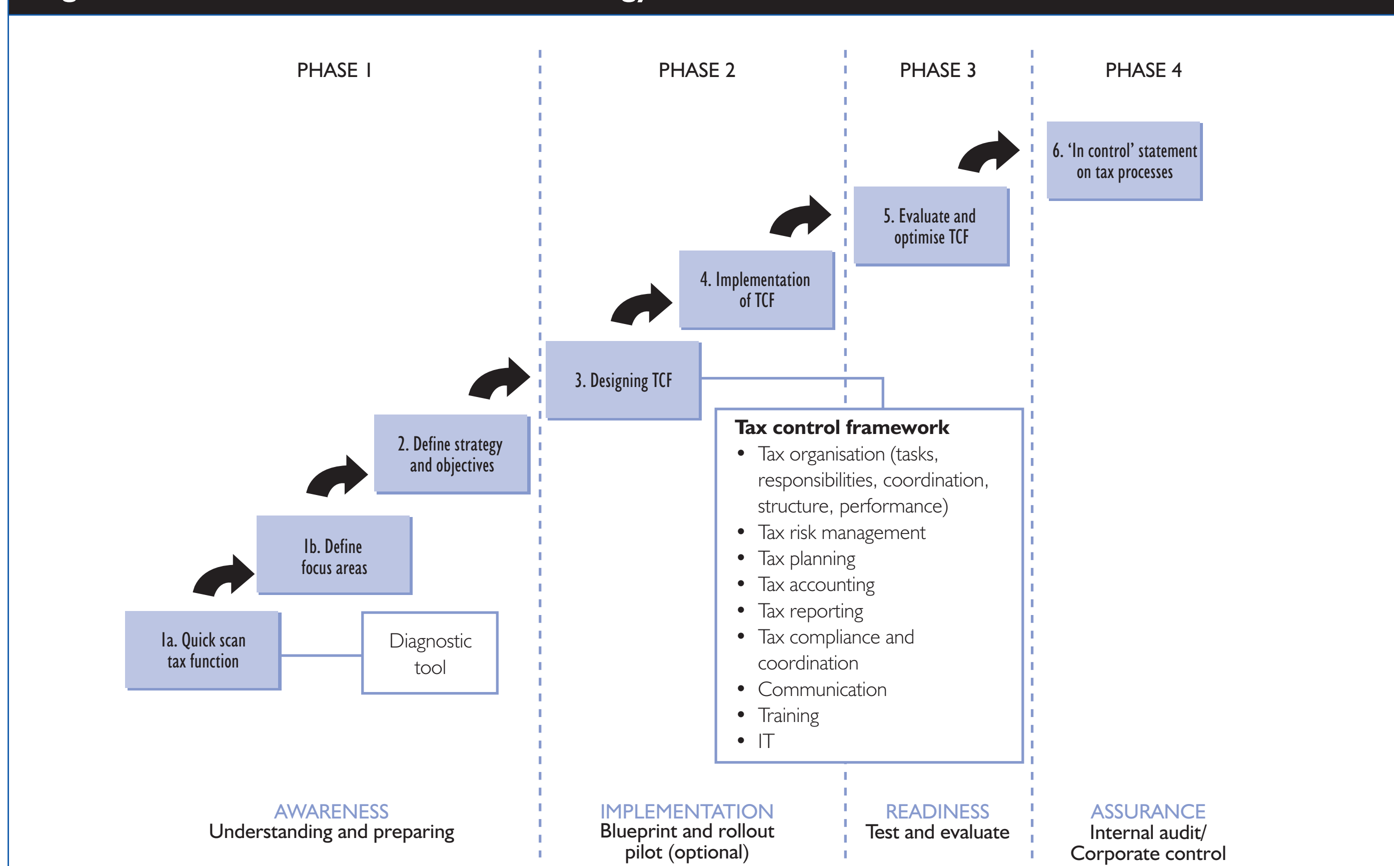
The other response is something resembling improvements to the tax control framework.

In our methodology (see diagram 1) the change management aspect deals with increasing the awareness of the organisation and flows through to the subsequent phases that will lead to assurance. It all begins and ends with a change in attitude.

Writing down just isn't enough

The biggest challenge for changing the performance of an organisation is overcoming people's resistance to change. When employees do not start to work in a new way, there is no need for a TCF. The organisation and its employees need to work according to the newly designed processes and controls, but they also need to show anticipatory behaviour and increased communication. Reluctance to change does not always originate from a negative attitude. Part of the reluctance to change comes from the fact that people are critical and need to be convinced of the value added by change. These

Diagram 1: Tax control framework methodology



people are generally the most valuable to a project because, once convinced, they become real sponsors of it.

To deal with the challenge, it is important to understand the rationale for the resistance to change. Here are some pointers.

Organisational inertia

All dynamics in most organisations are focused on creating inertia. Employees and managers are trained and coached to perform the job they have been hired for. Generally, the job description does not encompass anything about change or innovation (or tax issues, for that matter).

This inertia is also maintained by the way we use financial systems, reward systems, recruiting, training, office spaces and so on. All of these elements can, in many different ways, block change. For example, if the organisation decides to change the process for administrating VAT, what happens if there is no possibility to change access to the systems, change codes in the system or insert additional data?

Employees are unsure about what happens when, because of the implementation of a new tax policy, they have to start doing their jobs differently. What does this bring? Are they still appraised for what they do? Are other people willing to cooperate? Even more important than that, who says that the new job will not bring a lot more work than the former job? And are they already working more hours than they should?

Changes in balance of power

The second element influencing the willingness to change is the balance of power. Most employees and managers really appreciate the level of power that they have (how and why could they otherwise find any satisfaction in their current job?). Any change in the organisation means a potential shift in the balance of power.

The implementation of a TCF, for example, inevitably brings along a discussion about responsibilities. There are many tax elements in an organisation, from VAT and wage tax to corporate income tax, and it is not always clear who is responsible for what. Is wage tax the responsibility of the HR department or of the tax department? Is the filing of the return in Thailand the responsibility of the local finance manager or of the headquarters' tax director? This means that the implementation of these decisions constitutes a shift in power and workload. When employees or managers do not know the outcome in advance, or when the outcome is negatively affecting their work, they will generally not be eager to accommodate change.

(Negative) experience of previous changes

Previous experiences of change can have an impact on the way individuals respond to new changes. Two main forms occur. The first one is where people have seen many changes and are having difficulty finding the energy and time needed for the new change. They already have enough to do or cannot handle additional projects on top of their daily jobs.

The second form is bad experience. For example, previous changes have not brought the results needed because implementation was not thought through or executed appropriately. Or the change had a negative impact, such as leaving staff with more or less responsibilities than before or leaving them with increasingly difficult or boring tasks to perform. This means that employees are not likely to be supportive about upcoming changes.

Change is essential for successful control

Implementing a new way of working in an organisation means that change needs to be managed. This also applies to tax. Again, it is important to understand that resistance to change does not always mean a negative attitude.

There are four elements to dealing with change and realising that employees and managers are eager to participate in and contribute to the project:

- create political support;
- ensure right knowledge level;
- share responsibilities; and
- reward desired behaviour.

For some, these will be very obvious and common aspects. In the end, the quality of the execution of these aspects will determine the quality of the result.

Create political support

Creating political support is one of the most common elements of implementation. Most managers are aware of its importance. Few are able to create the political support appropriate to the aim of the exercise. Who are the stakeholders, what are their personal objectives, how do these match with the aims of the project? These stakeholders are not just the CFO or the audit committee but also HR, controllers, the sales department and so on. Once this is analysed, an appropriate action plan to create the right political support can be realised.

Explain the rationale, the triggering event. If you are not able to explain to your board or to your controllers why you propose specific changes, you have failed from the start. You must obtain legitimacy and support from your organisation to make people understand that they should change their behaviour. Managing by fear is far less effective than creating a platform of common understanding and having motivated personnel who understand why the change is needed.

Here is a practical example: how do you get business unit managers on board when control is a critical element of the TCF? Many financial managers are aware of the importance of control and it is therefore easy to convince them to support the project to increase control over the tax position. Business unit managers generally have different objectives: getting them to buy into the project probably means additional effort

Biography

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Eelco van der Enden is a partner in the tax management and accounting services practice of PricewaterhouseCoopers in the Netherlands. His main focus is on tax function effectiveness and tax accounting services. He publishes regularly on these topics. He also lectures at Nyenrode Business University Centre for Tax Management and Tax Assurance. He teaches both senior business executives as well as public sector executives. Over the past 20 years he worked for various listed companies in capacities such as non-executive CFO and head of tax, treasury and risk management.

Biography

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Robert van der Laan is responsible for the leadership of the tax management & accounting practice of the Dutch firm (about 600 people). His technical focus is tax function effectiveness, the new tax proposition being helping clients to stay in control of their tax function. He studied fiscal economics and business law at the University of Rotterdam and later completed the postgraduate programme in European tax studies. He was also instrumental in the development of the postgraduate course at the Tax Assurance Academy at the University of Nyenrode. He joined Philips Electronics in 1986 and PricewaterhouseCoopers in 1991.

from the project team. How is the TCF supporting their business? The most obvious approach would be to explain the reduction of risks with regard to their personal liability and the added accuracy in estimating the cash position they will receive and that these are the result of the project. Or, in the case of VAT, creating a competitive advantage by creating a structure whereby an exempt company does not need to receive a VAT invoice.

Ensure the right knowledge level

All of the people who are in some way involved with tax need to be made aware of the project, in terms of both content and process.

Communicating with the employees and managers involved in the process and aim of the project will help them understand the value of the project and what it might bring them. It also helps for them to understand what needs to happen for them to be able to contribute. Ignorance generally results in resistance.

Training and communicating on content is relevant because employees will be able to add the right things to the project. If your organisation is implementing a TCF and trying to get finance employees from the business units to administrate VAT topics properly and to signal potential risks, they need to know what they should be looking for.

Share responsibilities

The best way to get employees and managers to support the project and participate in its execution is by involving them. This way, you give them the opportunity to make the project (partially) their own. Success or failure of the project will then influence their perception of their performance. People will do anything to prevent having their name connected to a project that has failed and are eager to be in the spotlight when a project succeeds.

Involving people is generally fairly easy. The most common way is to give them a specific role in the project, for example the leading role for part of the project, a workgroup or a specific action. Another way is asking for their input in the design of the project ("what do you think we should do? What should the end result look like?"). This way, you confirm their importance to the organisation and to the project. Additionally, because they participated, for example, in the design of the project, they will convince those around them that it is an important and valuable project.

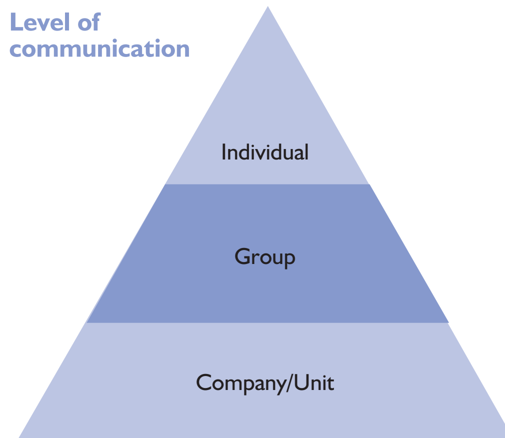
Reward the desired behaviour

The final way of encouraging people to participate in managing tax processes is by rewarding the behaviour that you see as the right behaviour.

Again, there are several ways to reward people. The most obvious way is to include it in their appraisals and increase their bonuses, wages or secondary package. However, be aware of the risks of including tax in bonus schemes if you are not confident that the controls are really in place.

Another approach is to reward people with honour and respect. Setting up a competition for the most innovative idea to make the project succeed can be very effective. Another

Diagram 2: Project communication



Key steps:

- Decide on objective: determine what the desired end result looks like.
- Determine target group(s): who do you need to communicate with and what are their stakes?
- Design the content: what should be the message?
- Choose the communication channel(s): what is the most effective channel?
- Determine the timing: when should the communication take place (and how often)?

possibility is to set up the project contributor of the month award. Simply mentioning people's valuable contributions to the project in shared communications can be equally effective. In our view, developing a specific, balanced scorecard for tax may do the trick.

Critical factors in successful communication and implementation

As always, the essence for getting great results lies in the quality of execution. Building a good project plan and an approach to communication are highly relevant. To highlight what is good, we have defined the most relevant elements:

- planning and responsibilities;
- communication, communication, communication;
- consistency; and
- creativity.

Planning and responsibilities

This means setting clear goals and deadlines and defining responsibilities in the project. This is essential to ensuring progress and to monitor the quality of the end result – be accountable for the results you (do not) realise. Proper planning will also enhance the consistency and integration of the different project elements.

Communication, communication, communication

Let people know what is happening. Keep them informed about progress. Share success. Over-communicating is a potential risk but is never an issue in reality. Good communication also means thinking about the target group, their goals and interpretations, the communication channel, timing and who should deliver the message (see diagram 2). This might sound easy, but execution is generally poor.

Consistency

All aspects of the implementation need to support the same message and goal. This means that all aspects of the implementation need to be tuned to each other. This will increase the credibility of the project and will also prevent inefficiencies.

Creativity

Communicate in different and new ways. To be able to get the right message across, especially the message of change, it is important to broadcast a new sound. This can be realised by using modern technology (podcasts or phonecasts, for example) or something not commonly used (lollipops in the company restaurant with a small info card attached, for example). Also, think about alternative ways of running workshops: make them fun without losing the quality of the content.

The changes in the current tax environment and the obvious need for increased control demand a response from companies. Most companies are already responding or considering their response to these changes. The theoretical part of this response is well covered by the TCF or tax risk management and control doctrine. The practical results depend on proper management of change and communication in the organisations. This is new for many of the people active in this sector, but it will create a very valuable additional dimension to the work of the tax professional. Gaining control is about more than throwing a tax accounting manual over the fence or implementing some IT tools. Above all, it is about people. The challenge is yours.

The authors express sincere thanks to Mare Straetmans for his active support in processing the material and formulating the article.

The role of technology

Technology is often misunderstood and under-utilised by most tax functions. However, its advantages are plainly apparent, says Mark Schutzman

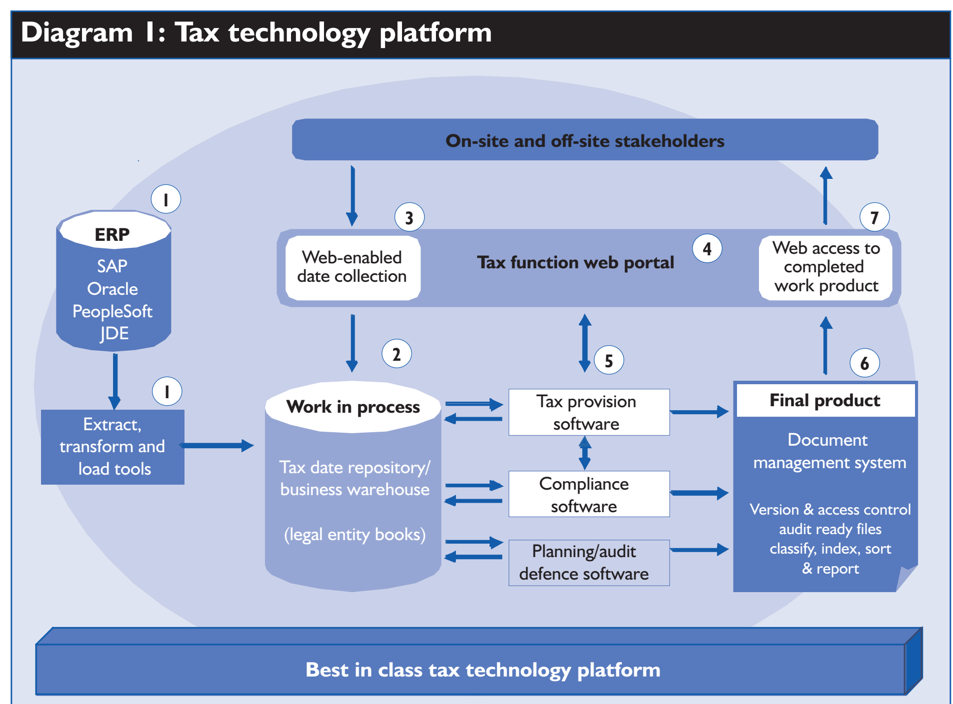
In comparison to counterparts in the overall finance function, tax has been woefully neglected when it comes to investment in technology during the last two decades. The current and increasing sophistication of enabling technologies can make a powerful difference to the ability of the tax function to produce its deliverables within the appropriate timescales and risk parameters.

To start with, a definition is needed to clarify what is meant by tax technology: what are the components and functionality and how do the separate components work together to deliver efficiencies, improve quality and manage risk? Once tax technology is defined, the value you should expect to derive from deploying some or all of these components can be explored.

What is meant by technology?

An example of a best-in-class tax technology platform is illustrated in the diagram below. We recognise that best in class is a vague notion and no single definition of what is best is widely accepted. Moreover, what is regarded as best varies considerably from one organisation to the next. Having said that, the model is based on:

Diagram 1: Tax technology platform



Extract, transform and load (ETL)

ETL brings together and combines data from multiple source systems into a data warehouse, enabling all users to work off a single, integrated set of data-a single version of the truth. The result is an organisation that has stopped spinning its wheels collecting data or arguing about whose data is correct, but one that uses information as a key process enabler and competitive weapon.

In these organisations, business intelligence systems (supported by ETL tools) have stopped being a 'nice to have', but are essential to success. These systems are not stand-alone and separate from operational processing - they are integrated with overall business processes. As a result, an effective business intelligence environment based on integrated data enables users to make strategic, tactical, and operational decisions that drive the business on a daily basis.

- visits to many of the global Fortune 1000 companies and first-hand observation of how these leading tax organisations address their technology requirements;
- developing the point of view in the course of many client engagements, after collaboration with senior tax executives and their finance and IT leaders; and
- discussions with senior executives from the leading tax technology vendors.

The component parts

Within diagram 1, the numbers 1 to 7 are intended to highlight the distinct components of the technology platform. Reference is made to each of these as follows:

1. financial system integration;
2. data warehouse;
3. data collection;
4. web portal;
5. third-party applications;
6. document management system; and
7. web access.

Financial system integration

Acquiring high quality data on demand and in the format needed to prepare tax computations and tax accounting figures is a widespread and frequently cited impediment to overall tax function effectiveness. Most tax functions spend an inordinate amount of time and effort collecting, validating and manipulating book data so that they have a good starting point from which to begin their tax work. The key here is improved use of technology to substantially minimise the effort required to collect, validate and manipulate data.

It is necessary to recognise that tax data is housed in various company IT systems that may include:

- ERP(enterprise resource planning) systems;
- financial consolidation systems;
- payroll systems;
- fixed asset systems;
- inventory systems; or
- other industry specific feeder systems (brokerage systems or R&D systems, for instance).

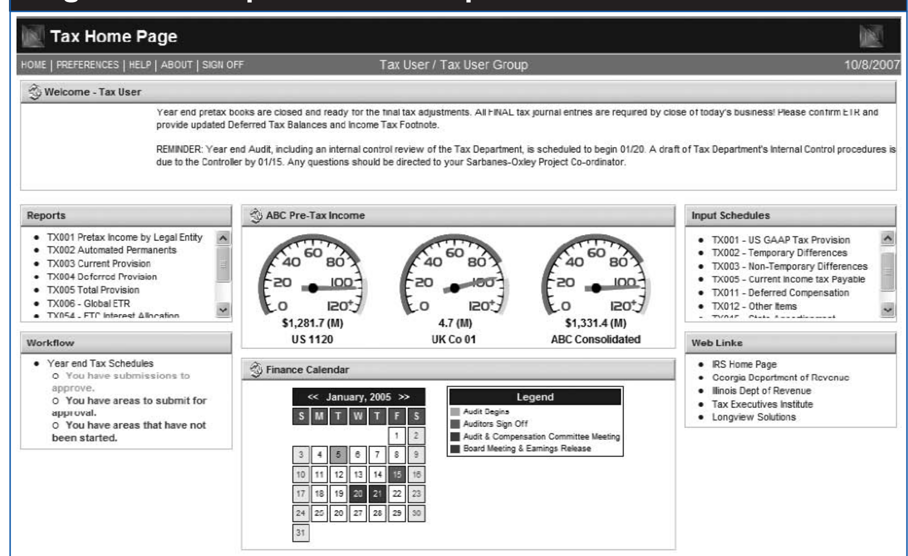
The traditional approach positions tax as wholly dependent on those who have direct access to the systems or who are the system owners such as controllers, accountants and finance personnel. In many instances, data collection requires tax personnel to place periodic requests for reports. This is typically a very inefficient process. It results in delays while waiting for a reply and then both validating it and manipulating the data (typically in a spreadsheet) so that it is in a useable format to support a tax computation or help produce tax figures for the accounts.

Consider how much of an advantage it would be if tax professionals used technology to the fullest extent possible. They could automate the data collection by reaching directly into the various and numerous source systems, then standardising that data within a staging area. Finally, they could push the standardised data set into tax specific systems such as tax accounting software, compliance systems and analytical tools.

The point here is not merely linking tax systems to financial systems but rather an integration of these systems. The missing link in the tax technology architecture of old are the tools that have robust data manipulation capabilities. These tools are defined as extract, transform and load (ETL). What are ETL tools and how can they provide a significant boost to the value of tax systems?

ETL tools have the ability to speak with virtually any other

Diagram 2: Example of a tax web portal



software application to extract and standardise relevant data and push it into another software application of your choosing. This has the potential to overcome the complexity, inefficiency and risks of collecting the numerous elements of book data from the disparate systems required for tax compliance and reporting.

Implementing ETL tools is a complex undertaking and not one the tax function should take on without support from finance and IT. It is highly likely that your company already licenses and uses ETL tools to support the finance or other business operations functions. To understand how ETL and business intelligence systems can support the tax function, it is necessary to learn how companies are already using these tools in support of other areas within finance.

Data warehouse

The second technology component is the data warehouse (DW). The terms data warehouse and data mart are often used interchangeably. While there are certain technical differences between the two, for the purposes of this discussion the two are combined. The term data warehouse means an information repository with a consolidated view of enterprise data, optimised for reporting and analysis. Data and information, both transactional and non-transactional, are loaded into the warehouse, often using ETL tools, from data sources as they are generated or in periodic stages. The transformation of data allows for dynamic queries and analytics, making it simple and efficient to run queries over data that originally came from different sources.

The benefits that a DW delivers include the ability to turn data into high-quality information to meet all tax function reporting and compliance requirements for all levels of users. Interactive content can be delivered to anyone in the extended enterprise – customers, partners, employees, managers and executives – anytime, anywhere.

Simply having a single source for all tax reporting and compliance information is a significant leap forward for most tax functions. However, what else can be achieved within the DW environment that could further enable tax effectiveness?

A tax DW should be regarded as an information hub that can bring automation to computation of deferred tax items, accept and store information from off-site locations and generally manipulate data so that it is in a useable format. It is the storage shed for robust and current tax-sensitive data that can be mined or pushed to third-party applications to facilitate analysis, audits, planning or forecasting.

Building tax DW functionality can be an expensive proposition. The single most viable alternative is to look within the finance function for either an existing DW or a DW initiative that could be extended to address tax requirements. It is usually simpler, faster and more cost effective to leverage existing IT architecture than proposing to build a new DW. A second alternative is external vendors with existing tax technology solutions who are looking to extend their offerings to provide a standard data model for a tax DW. It is still too early to tell if these vendors can produce a low-cost tax DW. And while they may provide a standard data model for the DW, significant investment is still required to identify all the data sources and configure and map the data from the source systems to the DW.

Questions often arise about the need for and benefits of a DW for a given company. The general answer is that the more disparate the sources of data, the more likely a DW will provide a significant benefit. For example, it is quite likely that a diversified global company with 20 separate businesses, countless business locations, numerous individual ERP applications and countless subsidiary ledgers will benefit much more from a DW than from a single domestic business with one integrated ERP.

Data collection

Tax seeks to collect data from controllers, accountants or tax personnel situated in foreign jurisdictions as well as information from domestic sites that is not readily available from the general ledger (ERP system). Many tax functions continue to rely on spreadsheets and email as the method of data collection from off-site providers. Naturally, this is not best practice as it is difficult to ensure that users do not make changes to the spreadsheet regardless of passwords, protected worksheets, columns and rows and hash totals built into the model. Many recipients modify the spreadsheet by adding or deleting rows or columns, adding worksheets, hiding cells or hard-coding over formulae. These common practices make it very difficult to extract data from spreadsheets efficiently as they lack standardisation when returned. This in turn leads to a significant data validation effort to ensure the information received agrees to the ledger or some other reliable originating source system. The other key weakness of emails and spreadsheets is the lack of version control.

Many companies are retiring their data collection spreadsheets in favour of web-based tax reporting packages. Essentially, they are migrating the functionality and in many instances the same look and feel of the spreadsheet to the internet, typically through a tax web portal. Upon entering data into the web form, it is instantly entered into the tax DW or directly into the tax technology application: in the right place, the right format and immediately available for reporting. This is a highly effective process to ensure standardisation and eliminate the effort required to transfer data from one spreadsheet to another.

Web portal

Tax function web portals are becoming increasingly commonplace. They serve as the central access point and knowledge-sharing nerve centre for tax operations. Diagram 2 shows how access to tax information can be centralised and easily acces-

sible through the internet.

The tax web portal example in diagram 2 contains links to tax-specific reports, web-based data collection packages, links to third-party research sites and access to workflow tools to manage critical processes. The centrepiece of many tax web portals tracks several key performance indicators (KPIs) or tax-specific values. In the illustration, pre-tax income in the US, UK and consolidated are represented in a speedometer format.

A critical component of the web portal is the ability to migrate the tax reporting package functionality to web pages that directly update the DW. A close second is the opportunity web portals afford global tax staff to have visibility in the compliance status, on a global basis, into the tax document management system and the DW for a first-hand view of completed tax returns, workpapers, research memos, financial reports and other company-specific work products.

Diagram 3: Types of tax software on the market today

International planning/foreign tax credits	Data analysis/mining tools
State planning, modelling and analytical tools	Global entity and compliance tracking systems
Transfer pricing	Interest and penalty calculators
R&D credits	Audit tracking tools
FAS109/IAS12	Tax data warehouse
FIN 48	Document management
Tax compliance/forms generators	Workflow
Transaction tax compliance systems	Tax calendar
Web enabled data collection tools	Web portal for the tax function

Third-party applications

Once book and other tax-sensitive data have been collected directly from source systems, standardised through ETL tools and stored in the DW, you have a very potent data set available to automatically populate technology applications for virtually any process required, such as planning, tax accounting, compliance and audit defence.

Recent years have seen a growing number of vendors servicing the tax technology market, with a number of companies having solutions available to address the list of needs shown in the diagram.

However, no single company provides a complete package covering all of these different needs. There are a number of organisations in the tax technology market focusing on different territories and regions, many with narrowly targeted applications. The changes in this area can be summarised as follows:

- Historically – tax compliance was the core tax technology with complementary modules built around it.
- Present – tax accounting and FAS109/IAS12 solutions have gained prominence and share the technology mantle as core tax technologies with complementary modules being built around each.
- Future – high-end DW systems with sophisticated financial consolidation, modelling and data-collection tools will emerge as the centre of the tax technology universe. This will be paired with ETL tools to standardise data sourced from disparate systems. Pushing this collection of high quality, tax-sensitive data to FAS109/IAS12 and compliance systems will become routine for the most effective tax organisations.

What is interesting about current provision technology is that the approach taken from vendor to vendor can be quite different. For example, some applications have been built around existing tax compliance tools and the stress integration between these two, some are written specifically for the provision and others are integrated with financial consolidation technology and stress the ability for automated extraction. With these differing approaches, the selection process for tax provision technology is critical as not a single technology represents the best of the three options discussed above.

While there are many choices in the field of technology, the ability to push data with the highest integrity to one of these third-party tools without the requisite validation and manipulation effort is a clear differentiator for those tax functions who claim optimal effectiveness.

Document management systems

The shared network drive remains the popular choice as the primary repository for completed tax returns, research memoranda, tax opinions, correspondence and supporting work papers. Unfortunately, the shared network drive is woefully inadequate, offers very little control and virtually none of the features of a formal, dedicated document management system.

Below is a brief list of the main features and benefits one can expect from a document management system.

- Secure and organised electronic workplace for all returns, receipts, work papers, tax planning and audit projects.
- Consolidate worldwide unstructured data from all sources, including any electronic documents, fax, email, images and electronic forms with access from any company location in the world through the internet.
- Audit-ready files.
- Secure access control and logging.
- Classify, categorise, sort and report all documents.
- Mine previously filed work papers, revenue audit responses and tax research papers using detailed context relationships and advanced search.
- Version control around all documents, especially key

spreadsheets, including the ability to restore prior versions and a complete audit trail of who made changes and when they were made.
- Eliminate dual file systems and the effort to ensure both are consistent, current and readily available between manual files and work papers, as well as electronic versions on the shared network drive.

Web access

The development of the internet has facilitated instant access to information from virtually anywhere in the world at any time. This information accessibility should be no different for the tax function. In addition to serving as the tax function nerve centre and key access point for data collection, the web portal can be leveraged to be the means by which tax personnel (and others in finance, if desired) can gain remote access to completed work products – such as tax returns, supporting work papers and legal opinions. Unencumbered access to data and finished work product enables speed and accuracy in completion of specific tasks regardless of location or time zone.

Leveraging existing finance function IT systems

Historically, the tax function has tended to operate as a silo separate from the finance function. The impact of this is that finance and IT leaders have become accustomed either to ignoring tax when looking at IT projects or bringing tax in so late in the systems development or deployment lifecycle that it is no more than a token step in the project plan. This tendency has been a significant contributor to today's inefficient tax processes and control issues and is no longer acceptable. Similarly, in most companies there is an expansive IT infrastructure that is not appropriately leveraged by the tax function.

The opportunities for the greater use of technology, and the generation of the benefits that these bring, have never been greater than they are today. A best practice tax function should be reviewing its IT plans and working through what needs to be introduced. Not only will the increased use of technology be beneficial to those people who are doing too much manual manipulation of data; it will also greatly improve the quality of information through improved business controls and risk management.

Biography

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Role of the head of tax

Fabio Dell'Anna and Andreas Staubli outline issues for heads of tax to consider in a rapidly changing world

Against the backdrop of global regulation and finance transformation, the ability for a multinational company to robustly disclose and report its worldwide tax position in a transparent manner goes beyond the technical implications underlying tax planning and tax compliance. These changes in the way of doing business require new capabilities of in-house tax departments and additional skills other than those traditionally required from heads of tax.

It is this challenge that brought leadership in tax to the forefront of tax function. Strong leadership is required in order to manage the tax affairs of a business effectively and ensure that tax is taken seriously in an organisation. The focus is therefore on the head of tax, whose key skills can be defined as demonstrating the leadership of the tax function by designing and embedding the tax strategy. The definition of a tax strategy is consequently only the beginning of managing tax affairs. A genuine leader is able to use this tax strategy as a communication tool and a contract with stakeholders when fulfilling the role of head of tax.

Is the role of head of tax clearly defined?

There are many people in the industry holding the title head of tax who, if we take a closer look, actually have different jobs. The same goes for the staffing and design of tax departments. From the surface, things look fairly similar. However, just below the surface the differences become obvious. It is rarely seen that a tax department is not involved in tax accounting and reporting. In one company this involvement might be limited to advising the controlling department while, in another company, the tax department takes full responsibility for accounting of income taxes in the financial statements. The same differences apply to involvement in: (i) M&A; (ii) management of teams; and (iii) compliance, among others.

In general, it can be said that the aim and purpose of tax departments or in-house tax functions with multinational companies is to take care of relevant fiscal affairs that arise within the business context and existence of the company. This function of in-house tax departments is common to all companies.

In this context a key leadership skill required of a head of tax, in order to be successful within the organisation, is to understand his/her role and the role of the tax function. Moreover, what is their value-added role in the context of the organisation's business objectives? What is the starting point and what are the boundaries of the playing field for the head of tax?

Leadership: development of the strategic plan

Based on the understanding of what is important within the organisation, a genuine leader will develop a strategic plan. Designing a tax strategy is all about making choices concerning how, who and what? It is all about what to do, what not to do and what

Biography

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Biography

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Andreas has been an international corporate tax partner with PricewaterhouseCoopers since 2000. Within PricewaterhouseCoopers Switzerland, he is the tax leader for the country's German speaking part. He is also the Global Insurance Tax Leader of PricewaterhouseCoopers. He is a certified Swiss tax expert and graduated from the University of St Gallen with a degree in finance and accounting. Andreas gained his international tax experience during his secondment to the tax planning group of PricewaterhouseCoopers in New York in 1999/2000. He is the lead tax partner for several multinationals and he specialises in international tax structuring, insurance taxation as well as tax function effectiveness and tax accounting (US GAAP and IFRS).

the focus should be on. Making choices implies that there are things that the tax head will not do and, if appropriately agreed, communicated and documented, not be held responsible for. Upon designing a strategic plan, the wider context, including influencing factors and operational capabilities, has to be taken into account. Without the right environment and attitude, any strategic document is worthless and cannot be implemented.

What are fiscal affairs?

The key here is to reach agreement as to what is to be managed by the head of tax as part of an overall tax strategy, as well as excluding that which lies outside the definition. For example, where one company includes all direct and indirect governmental duties, another company may limit the definition of tax affairs to only direct governmental duties and levies regarded as income taxes, ignoring above-the-line items. It is inevitable that the person heading the in-house tax function must obtain a complete overview of this playing field, including its outer boundaries. Not only is taking the initial steps in the design of a company's tax strategy a pre-requisite to being able to successfully manage in-house fiscal affairs, it also forms the fundamentals of establishing a leadership role for tax within the organisation.

Alignment: be aware of constraining factors

Designing a strategic plan does not start with a blank sheet. Structure, business strategy, values, the history of the company and other decisions that were made by the company pre-define the space to manoeuvre in. What does this mean while talking about tax strategy and guiding the direction of the tax function? Whereas in one company certain choices are pre-defined, another company may have pre-defined completely different choices. Take for example a listed company with headquarters in Europe. Due to the nature of their business and core assets, their revenues arise in high-tax jurisdictions. One pre-defined choice of the company is treasury-related: the policy is to finance local subs by means of equity and to repatriate dividend flows to group level. Another pre-defined choice is asset related: the policy is to have core assets in ownership by local subs, no (intra-group) lease or any other similar structure. In an analyst report it is noted that the effective tax rate of the main competitor (whose assets are located in the same high-tax jurisdictions) is significantly lower. At first sight the two companies are fully comparable from a business perspective. However, due to the pre-defined choices of our example company, the possibilities for tax saving structures are limited in comparison to its competitor. The competitor may have other pre-defined choices that do not limit the room for tax planning initiatives. Not only does the head of tax need to be acquainted with these pre-defined company decisions upon designing the tax strategy, he or she (as a great leader) must also, in a condensed manner, be able to demonstrate in what way these decisions affect tax planning abilities. It is up to the CFO or the executive board to define priori-

ties: lower tax rate or treasury/asset policies. Once priorities are defined, it is up to the head of tax to align and focus the tax resources to maximise the contribution to the overall results of the company.

Stakeholder needs and requirements

Determining the tax strategic plan is asking the question: what does our company want to achieve with the tax function? Consequently, designing the tax strategy is about providing adequate responses to the needs the company is facing in the field of taxation. In this aim, the head of tax needs to be aware of and fully understand the needs and requirements of the internal and external stakeholders. As the leader, he is able to critically assess and prioritise these requirements and separate needs from preferences. Take, for example, a company operating in the consulting business. Revenues are generated by cross-border consulting projects won through tenders or bids. One of the deliverables defined in the tax strategy is that the tax department is there to facilitate the bid processes. As a consequence, the company's bid managers become stakeholders of the tax function. The resources of the tax department are in sufficient for full involvement in all of the numerous bids that take place each year. For the tax department to play a pivotal role, it is the head of tax who must understand the interests of the company's bid negotiators. As the leader, he is able to clearly explain to what extent his department can deliver added value to the bid process. This includes the ability to make the process negotiators familiar with where tax aspects may become crucial and where not. Policy documents may serve to lay down mutual understanding and interests but should be re-assessed continuously and, where necessary, adopted.

Clara Wong, VP of Tax, Mattel said: *"Corporate tax professionals have to understand the business and stay in front of changes in the business. We often find ourselves in the role of a translator - translating key tax concepts so they have relevance to both finance and non-finance business functions".*

Creating the breeding ground

Once an agreement has been reached as to which fiscal affairs are to be managed as part of an overall tax strategy and after having understood and taken into account all stakeholder needs, it is time to re-assess the tax strategy plan. This means reassessing whether the defined plan fits pre-defined parameters that cannot be changed. The strategy plan should be supported by and well grounded within the organisation. If not, begin discussion and communication with stakeholders: execution will fail without their support. A tax strategy is worthless if its roots are not well grounded in fundamentals such as culture and values, structure and processes, skills (including training) and attitudes and mindset, all supported by adequate technology, measurement and incentives. Leadership implies familiarity with the company fundamentals, and it is the tax strategy that must be adapted to the company values, not the other way around.

Bart Kuper, Head of Tax, TNT said: *As Head of Tax you need to have capabilities to liaison at board-level, at high conceptual level. See it as a game of chess: there are different dimensions but you have to condense the complexity in a simple way".*

Living the tax strategic plan –the head of tax becomes a process and people manager

The head of tax is there to execute the plan and to deliver, with his team, what the stakeholders require. He or she is no longer only a tax technical expert as in the past but is increasingly a process and people manager. Why?

Clara Wong, VP of Tax, Mattel said: *The tax function is far more valuable organisationally if it can effectively translate tax concepts that are understandable to the business units and contribute to their business objectives".*

As the financial and reputational risks of tax make it a boardroom matter, the list of deliverables or responsibilities of in-house tax functions has grown significantly. This can be seen in the area of tax accounting and reporting, where the introduction of complex tax accounting rules and the impact of potential errors on financial accounts has made it a boardroom topic. At the same time, changes in accounting for income tax regulations remain continuous, with the expected convergence of IFRS (IAS12) and US GAAP (FAS 109). Increasing complexity and the increase of responsibilities puts the pressure on in-house tax functions. With a broader responsibility, it is important to realise that focusing on one thing could be lethal. Delivering on all fronts is now standard.

Executive boards demand transparency and no surprises in a world where shareholder value remains the top priority. But there is more: in some jurisdictions tax authorities (the Netherlands, for instance) are changing their working relationship with corporate taxpayers, requiring adequate processes and controls as the basis for these time and cost-saving working methodologies. Another external stakeholder of the tax function is the external auditor. They look with growing interest at the details, processes and controls behind the tax position in the annual account. The stakeholders have various interests and requirements, again leading to an increase of pressure on tax departments.

All of the additional attention and pressure from inside and outside the company leads to the fact that in-house tax functions are becoming increasingly complex organisations. If departments are to be headed by incisive leadership, this

requires more expanded capabilities than only tax technical knowledge.

The vital leadership skills for the head of tax

As in the past, in today's environment outstanding tax technical, tax accounting or computational skills are inevitably necessary to establish an effective tax function. However, today these skills are not enough. The head of tax needs the skill to communicate at all levels of the company, from the office floor to the boardroom.

People management and boardroom presence

With tax departments becoming increasingly complex organisations, there is a growing need for people management. A great tax leader creates the structure that holds things together: he or she implements the processes that make members of the tax team contribute to these items, which then contribute to the broader picture. People management means understanding the art of getting things done through people and understanding cultural differences. In terms of tax departments getting things done through experts with detailed knowledge located around the globe, a leader keeps them focused, motivated and challenged.

> **Bart Kuper, Head of Tax, TNT** said: *"The challenge when it comes to manage tax staff is to keep them focused on items that have the most impact at consolidated level. At the same time most appealing for them is if they see that their work has true impact".*

Tax experts tend to dive immediately into details. The tax leader has to understand what motivates his people without controlling every single aspect and detail. Hence, he or she needs to see the broad picture and set the parameters for the actors within the tax function. The choices that are made while defining the tax strategy must be communicated, made clear explicitly to staff within and, to a certain extent, without the tax function.

The playing field for the head of tax is spread through the entire organisation: it includes the full spectrum, from day-to-day people management to fully-fledged discussions in the boardroom where he/she must understand stakeholder needs and describe complexity in a condensed form.

When deciding on a potential transaction, the board should be informed about tax issues that have, or can have, a material impact on group financial statements. It is up to the head of tax to abstract the message, utilise the tax expertise of his people to its full extent and translate the tax technical and tax accounting merits into business language. This is of particular importance when communicating with decision makers who do not have a tax technical educational background or expertise.

Internal and external profile and impact

Internally, the tax function might not be taken seriously to its full extent and may be overlooked or overruled. It is up to the head of tax to arrange the internal credits that are needed. For this purpose, the values of the tax strategy are to be acknowledged and incorporated in contractual arrangements with stakeholders.

> **Clara Wong, VP of Tax, Mattel** said: *"Tax appears to have come out of the "back room" so to speak and becoming more relevant to line management. Many corporate tax functions have earned a spot at the table when business changes are being considered and particularly when deals are being contemplated".*

Externally, tax authorities and revenue bodies are becoming rather sophisticated and well equipped. Knowledge demonstrated through active involvement in professional organisations and pressure groups helps to create external profile and impact: so do outstanding negotiation skills. An extra flavour is added through communication of the values included in the tax strategy. Additionally, it helps to take the tax strategic plan into account when working with external stakeholders. Most importantly, providing clear responses to the needs of stakeholders is essential. Take a company that obtained external advice on the deductibility of real estate expenses for tax purposes. The 20 pages of advice contained a clear explanation of the tax technical merits of the position taken by the company. The advice could serve as a strong line of reasoning for the company's interpretation of the law in a defence file towards a potential audit undertaken by tax authorities.

The usefulness of the advice was limited for the purpose of signing-off the financial accounts by the external auditor. What the external auditor needed was a firm conclusion that the position taken would, more likely than not, be sustained upon a challenge from the authorities. It goes without saying that the detailed elaboration of a tax technical interpretation alone is not sufficient for this purpose. It is the task of the head of tax to have his or her resources do the utmost to meet all needs and requirements.

Measuring performance

With increased scrutiny on the structure and management of tax functions, the focus will shift to establishing measuring instruments and benchmarks.

At present, the market continues to use the effective tax rate as the measuring instrument for tax functions. But a measuring ratio can be applied successfully only in those situations where tax planning (savings) is the only deliverable of the tax department. What is now required in the industry is that heads of tax and their departments are measured on their overall performance.

Bart Kuper, Head of Tax, TNT said: *"Measurement by means of Effective Tax Rate does not work in the short run. As a tax department you are not able to control one of the two items that constitute Effective Tax Rate, being positive or negative income".*

What are the available alternatives? From its origin as a cost centre, a tax department can be viewed from the perspective of being an internal service provider. The overall quality of these services, their impact and the value added to the business, as well as their response to the needs of stakeholders, could be measured by satisfaction reviews. The results are to be gathered and summarised in balanced scorecards whereby the parameters of the balanced scorecards are taken one-on-one from the tax strategy. What gets measured gets done. It is also in the interest of the tax leaders in the industry that their performance in their broadened roles is adequately measured. It goes without saying that the importance of adequate measurement goes beyond the merely compensational aspects.

Leadership development increasingly emerges as the factor that will determine the success or failure of the tax function's emerging role. While various members of the tax function will have leadership roles in their own particular areas, the main leadership role will clearly be carried out by the head of tax.

The heads of tax demonstrate leadership of the tax function by designing and embedding the tax strategy within their organisations. Their primary task is to solve complex business problems with their teams and not to solve tax technical issues themselves. Hence, while technical tax knowledge is important, it is leadership and managerial skills, as well as the ability to work effectively with top management and the board of directors, which are critical to the future success of the tax function. For this reason, there is a strong emphasis on broad business management, communication and leadership skills.

This active leadership role is to be supported by a tax strategy, which is the main organisational tool to improve the effectiveness of a tax function. It serves as a primary communication vehicle to the board, management and tax personnel, regardless of their geographic location. Moreover, it constitutes a contract with stakeholders and is a pre-requisite for a best practice tax function.

The challenge is to have performance metrics for the tax function that tie in with the overall tax strategic plan. The performance indicators need to reflect the key strategic goals. Only then will the tax function genuinely be able to show the value they are adding to the business.

We anticipate significant developments in this area in the years ahead and are looking forward to contributing to these developments.

Stakeholder communication

Over the last few years there has been a great deal of change in the global tax environment, calling for effective communication between the tax function and stakeholders in tax, says Tim Cox

Increased regulation and increasing complexity in tax laws has resulted in tax becoming highly specialised and consuming increased management resources. There has also been an increase in the level of interest in tax from a diverse range of stakeholders who are not tax experts and are demanding explicit and improved information in relation to a company's management of tax and tax risk.

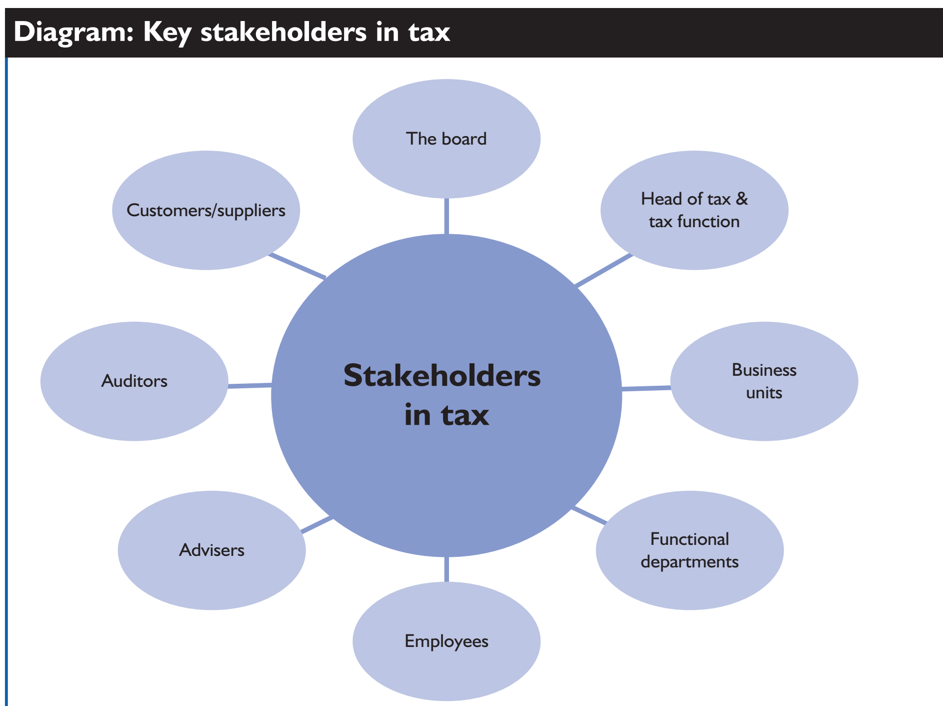
The key stakeholders can be summarised as in the diagram(diagram 1).

Discussions with different stakeholders indicate that there is a clear desire for increased transparency in relation to tax matters. Stakeholders want to understand a company's tax strategy and how that strategy is being delivered by the board and management.

A structured approach

The overall perception for many non-tax people is that tax is a difficult and complex subject, thus making effective communication particularly important. While a structured approach to communication may feel overly prescriptive, it is helpful to consider some basic but often overlooked issues. A best-practice approach to communica-

Diagram: Key stakeholders in tax



tion with the stakeholders in tax might consider and articulate the following.

- **Why.** What are you aiming to achieve through the communication? What do you want the stakeholders in tax to do once you have communicated with them?
- **Who.** Which stakeholders in tax (both internal and external to the organisation) need to be reached through the communication? Where do the different stakeholders sit in the order of priorities?
- **What.** What messages need to be delivered around tax? For example, internal messages may be delivered around tax accounting, while for external stakeholders there will be messages around corporate responsibility.
- **Delivery.** What is the best method for delivering the message?
- **Review and refine.** Once a delivery mechanism has been in position for a period of time, the success of the communication needs to be reviewed and refined if necessary.

What do you want?

What response do you want from the various stakeholders in tax? Responses may fall into the following four categories.

- **Knowing.** Imparting knowledge to stakeholders (the investor community, for instance).
- **Thinking.** Stakeholders will start giving some thought to the imparted knowledge and how it might affect them (customers and suppliers, for instance).
- **Feeling.** Stakeholders start to buy-in (or not) to what they are seeing and hearing (the board, for instance).
- **Doing.** Stakeholders will take action in relation to the communication (finance people who are providing information for tax returns, for instance).

People normally need to go through the first three phases (sometimes more than once) to get to phase four. One of the major failings in any communication programme is the expectation that the recipients of knowledge will automatically move into the doing phase without having had a chance to think things through and feel comfortable with what they are being asked to do.

Communicating with internal stakeholders

The tax function needs to communicate with various different internal stakeholders, each of whom require different communication considerations.

The board

Buy-in from the board is required for the overall strategy for managing tax. In terms of communication, we believe that the tax function should have regular (at least once a year) access to the board. We see three key areas of focus for communication to the board: an understanding of the group's key tax risks, involvement in setting the overall tax strategy and providing oversight so that the controls in place deliver the required strategic outcomes.

Setting the overall tax strategy

While the strategic tax plan will undoubtedly be drafted by the tax function in conjunction with the chief financial officer(CFO), we believe the tax strategic plan should be reviewed and discussed by the board at least once a year. Potential areas for communication to the board include:

- the balance between risk and reward;
- the tax corporate responsibility agenda;
- where the organisation should be focusing its efforts in relation to tax;
- the controls in place around tax risk;
- communication with external stakeholders; and
- the organisation's reputation in respect of tax.

Reviewing tax risks in the business

The board should be aware of the major tax risks in the business and what is being done to manage these risks. This is something that should perhaps appear on the board's agenda more often than just once a year.

Ensuring appropriate controls are in place

While the board will not need the detail, as part of their corporate governance agenda the board should make sure that they are confident not only that proper controls are in place for managing tax and tax risk but also that there is a monitoring process in place to ensure that these controls are being implemented.

Increased regular communication will be needed with the CFO (and probably the chief executive officer(CEO) as well). In many organisations, the head of tax and the CFO meet on a monthly basis to ensure that the CFO is aware of and consulted on all major tax issues, and that the tax function is aware of what is happening more widely in the business.

Business units

Tax needs to be embedded in many parts of the business and it is crucial for proper management of the tax affairs of a group that the tax function has good working relationships with those in the business. This is often achieved by tax people "marking" their counterparts in the business so that mutual understanding and trust builds up between the two. A trusting and open relationship between tax and the business is much more conducive to a joint solving of issues.

Within the tax function

One of the key areas of communication is within the tax function itself. When there are only a small number of people, this can probably be somewhat informal. However, for large tax functions, and particularly where there are people based in different business units or countries, more formal processes

than in small tax functions are essential.

Communicating with external stakeholders

Communication with the investment community and government authorities is a process with implications beyond the scope of this article, but some of the considerations need to be briefly mentioned.

The need for transparency: the Tax Transparency Framework

Various discussions with stakeholders support the desire for enhanced transparency of the company's taxes on which to base their decisions. In the past, tax has been seen as a deeply technical subject that is best left to the experts. Tax functions have also been cautious about providing information on their tax strategy and tax numbers on the basis that such information might be understood or could lead to increased scrutiny, particularly from revenue authorities. However, the current business environment is putting increased pressure on companies to provide additional information to stakeholders about tax. The view of stakeholders is generally that the benefit of increased transparency outweighs the risk of increased disclosure.

In response to the desire for increased transparency, PwC has developed the Tax Transparency Framework, which provides criteria for communication to external stakeholders in three key areas:

- tax strategy and risk management;
- tax numbers and performance; and
- total tax contribution and the wider impact of tax.

Tax strategy and the approach to risk management is considered an important part of stakeholder communications, providing context for the tax numbers and providing an explanation of how the company intends to manage taxes going forward. This should be accompanied by clear disclosure of the material tax risks faced by the company.

In terms of tax numbers presented in financial accounts, the Framework encourages a clear explanation of why the current tax charge differs to the statutory rate applicable to accounting profits, a reconciliation of cash tax payments to the tax charge and forward-looking measures for tax, such as a forecast-effective tax rate.

The purpose of disclosing a company's total tax contribution is to provide for transparency of the wide contribution in all taxes and its impact on shareholder value. In this way, the Framework encourages clear communication of the total economic contribution of a company in taxes.

Influencing governments

The company's total tax contribution in a particular country is also a good starting point for a dialogue with government authorities. However, in many countries the discussions between companies and government authorities go much further than how much tax you should or do pay to them. It is argued that it is the duty of a responsible tax function to engage with government authorities with respect to both tax policy and the creation of tax law. This is not just a question of arguing for a favourable tax break: it involves helping to create an improved tax system that reduces the burden for all concerned.

How you deal with governments in this respect will vary considerably from country to country. Local custom and culture clearly needs to be taken into account. However, a few questions (as below) apply across a number of jurisdictions and may be helpful when developing a communication plan.

- What do you want to influence?
- To whom should you speak?
- What is the best argument to present?

You will need to evaluate your own position and the contacts you have and then put a campaign plan into operation. This should involve others within the organisation: indeed, the largest businesses often have a government-relations adviser to help with exactly this type of work.

The communication plan

Effective communication considers what diverse stakeholders need from the tax function, what the tax function needs from them, the specific goals of the communication and the appropriate method. The best-practice tax function should pull these various strands together into a comprehensive communication plan that sets out:

- who you will communicate with;

Biography

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Tim Cox is a tax partner with PricewaterhouseCoopers in Australia, specialising in corporate tax management, compliance and reporting. He advises major corporations on the effectiveness of the tax function and managing tax risk globally. He has a significant amount of experience working with major corporate groups to establish effective governance practices, including advising on systems and processes for the management of global tax reporting and compliance. He has a broad experience in the management of domestic and international tax established over a number of years advising Australian and multinational corporations.

- what both sides need from each other;
- how the communication will take place; and
- how often it will happen.

The plan can then drive the communication between the tax function and both internal and external stakeholders.

An important consideration will be how to communicate with the various internal stakeholders, which will require some thought being given to the nature, style and detail of the communication. Much of the upward communication from the tax function may be achieved through regular presentations to the board or board audit committee and CFO. Given the volume of information presented to the board and senior management, it is crucial that communications from the tax function are clear, concise and presented using non-tax technical language. A common mistake made by tax functions is to provide excessive detail on tax technical risk areas which other non-tax business people find difficult to interpret.

Communications with business units and other corporate functions should be clear and concise around the impact of risks, issues and tax law changes and, again, written in non-tax technical terms.

Communication then and now

The question arises whether tax functions give as much attention to communication as the subject warrants. In the past, the tax function was often seen as a black box minimally connected to the rest of the business. Clearly, things have moved on a long way since then but there is still a lot to be done. A well-considered communication plan that clearly identifies the reciprocal needs of the tax function and its stakeholders will go a long way towards ensuring effective communication.

Structuring the tax function

Tony Elgood sets out some of the structural options and comments upon their pros and cons

In our work with many tax functions around the world we have seen a number of different ways of structuring and organising the tax function. There are clearly numerous options. However, we do not believe that there is only one right answer that will suit all businesses.

Role of the tax function

There are three different groups of people who are involved in the running of the tax affairs of any business:

- in-house tax function;
- shadow tax function; and
- external advisers.

It is beyond the present scope to consider, for example, how the finance function or the human resources department organises their part of the shadow tax function. And we would not attempt to comment on how the external advisers might be organised. For now, it is best to focus purely on the first of these three, the in-house tax function. They are the people who are dedicated tax specialists and who probably have tax somewhere in their job titles.

The starting point for organising the structure of the in-house tax function is a decision as to which activities are carried out by the in-house team and which are

Table 1: Responsibilities in the tax function

	Ownership of tax deliverables				
Deliverables / Types of tax	Strategic plan	Planning	Accounting & reporting	Compliance	Audit defence
Corporate income taxes					
Indirect/sales/taxes					
Employment taxes					
Customs duties					
Environmental taxes					
Withholding taxes					
Property taxes					

dealt with by the other parties, the shadow tax function or the external advisers. The completion of the table on the previous page, showing who is responsible for what and in particular whether the tax function's role is high, medium or low for each tax deliverable, is therefore the starting point for discussions of how the tax function should be structured.

Key questions

Whatever the size of your tax function, in designing the structure of the function you should be looking to answer two key questions:

- how should the tax function be grouped into distinct organisational units and teams, enabling the people to:
  - focus sufficient attention and resources on the priority requirements that the tax function must meet (the key areas of focus and the five deliverables); and
  - obtain the best value from the company's overall tax resources; and
- how should the relationships between those teams be managed?

There are a number of different ways that you could structure your in-house tax function.

Head office v business unit model

Particularly for medium to large businesses, the first question to consider is whether you wish to operate the head-office model or the local business unit model. In the head-office model the tax function is highly centralised: in the business unit model, local businesses take more responsibility for their tax affairs and have in-house tax resource within that business.

In answering this question you should consider the company's overall organisational strategy with respect to the roles and functions of the corporate centre and its relationships with individual business units. Additionally, you will need to consider the environment in which the tax function must operate. For companies that have numerous disparate businesses, a more decentralised model may appeal, so that resources can be aligned closely with where and how key business decisions are made.

Some companies give prime importance to the benefits of scale and greater specialisation that are achievable within a centralised structure, while others place greater emphasis on the benefits of delegating accountability and control to the management team of individual business units. Should the tax function not be consistent with the rest of the business in this respect?

It has been interesting to note over the past few years that, even where businesses operate the local business model, there has been an increasing tendency for these local tax people to have their main reporting line into the global head of tax, with perhaps a dotted reporting line to the local business. This structure may be of value in embedding a consistent approach to tax while keeping the tax function close to its internal business stakeholders.

A comparison of the advantages and disadvantages of the two models is set out in the table below.

The organisational options

The options for both head office tax functions and local business unit teams include organising the people by:

- the main deliverables: tax planning, tax accounting, tax compliance and audit defence;
- different types of tax specialisations, such as corporate income taxes, indirect taxes and employment taxes;
- geography, by county or region, perhaps headed by an international tax manager;
- business unit – in line with the rest of the business;
- a project-based organisational structure, whereby people in the tax function are organised in team-based structures of limited duration – typically 12 months to 18 months – with specific responsibilities for the key areas of focus (the near-term priorities for tax); or
- the tax function enablers (people development, controls and risk management, process improvement, data management, technology and communication, for example), though this is not something we have seen implemented.

These basic options are often combined into matrix structures so as to obtain the benefits of focus in two (or possibly even more?) distinct areas. For example, a matrix structure might

Table 2: Head office model v Business unit model

	Advantages	Disadvantages
Head office model	• Strong focus on group tax charge • Easier to align with group strategy • Good co-ordination • Easier to restrict headcount • Provide a pool of expertise	• Can be seen as remote from businesses • Will not have detailed territory specific skills for overseas entities • Can be perceived as a "head office overhead"
Business unit model	• Close to business • Likely to have local-territory specific tax skills • Can reduce reliance on local advisers	• Less focused on group co-ordination or strategy • Can lead to inconsistent positions with different tax authorities • Transfer pricing can be difficult to co-ordinate • Harder to supervise activity and control group tax costs • Reporting and/or loyalties will often be to local management • Harder to ensure optimum resource levels • Tax staff in smaller locations can feel isolated

be created whereby the line management structure was defined according to the main deliverables but functional reporting lines were established to run across the geographies. However, matrix structures typically have one management dimension that predominates, which in practice can limit the scope for achieving a really sharp focus on more than one of the alternative options summarised above.

For those groups aligned with the deliverables, it is worth noting that we are increasingly seeing a tax controller role within tax functions, someone who is responsible for the tax figures within the financial statements and related reporting. The skills of this role are more around accounting than tax. Additionally, we are also seeing people with ownership of people development, controls and risk management, process improvement, data management, technology and communication (the enablers). However, it would be unusual for the enablers to be the predominant arm within a matrix structure. Our experience has shown that some level of alignment around deliverables is desired but, unless the right matrix is also implemented, these deliverables-based structures tend to result in silos that can result in dysfunctional organisational models.

Table 3: Different organisational structures

Organisational structure	Advantages	Disadvantages
By the deliverables	• Facilitates development of particular expertise • Facilitates efficient and consis tent delivery	• Could limit the scope for focus of attention on key priorities / areas of focus
By different types of tax specialisation	• Facilitates development of deep expertise in particular types of tax specialisation	• Could lead to business processes that are inconsistent across the organisation and costly to operate
By geography	• Provides for focus on country-specific/regional issues • Often aligns with the business	• Could involve focus at the coun try or regional or BU level at the expense of corporate issues
By business unit	• Clearer alignment with overall corporate strategy • Alignment with senior	• Possibly more resources needed to collaborate with business units and other tax
Adopt a project-based organisational form	• Provides a sharp focus on key priorities • Provides for flexible deployment of resources according to business requirements	• Could limit the scope for providing robust structures within which to develop deep expertise and struc tured career development of staff

Where the geography structure is combined with a tax specialisation structure, there is a tendency for the corporate tax people to be in the senior roles with sometimes undue emphasis on these taxes at the expense of the others. Technical competency is but one part of the overall skills of tax professionals, and to have this as one of the key drivers of the tax function's structure is perhaps an historical position that needs challenging.

One of the key drivers in selecting the best organisational structure is to carefully consider how the rest of the organisation (outside of tax) is structured and where and when key strategic decisions are made. Our experience has been that if the company as a whole is structured tightly around global business units, key strategic decisions tend to be made at that level. If tax is then structured by functional specialty and geography, it may be some time before tax is engaged in the process (usually after decisions are made and corporate geographies are asked to implement changes). If tax is to be a relevant business partner to other business units, it must structure itself to facilitate collaboration with key stakeholders. One highly diversified company assigned its senior tax planning resources to business units but retained a deliverable/geography matrix for the rest of its organisation. The tax function's ability to interact with key stakeholders has since improved dramatically. In the right circumstances, this approach is clearly a best practice.

A comparison of the typical advantages and disadvantages of these different organisational structures is set out in the table above.

We do recognise that in the smaller tax functions there will undoubtedly be significant multi-hatting with the same people responsible for a number of different areas. However, in our opinion this does not do away with the underlying principle that the organisation of the tax function needs to be thought through and be appropriate to that business.

Finally, you need to consider how the tax function will be managed as a whole to obtain the best value from the company's overall tax resources and the benefits from collaborative working among people in the different teams. This might include a staff pool concept at lower levels, which overcomes the potential for narrow technical focus too early in a tax career. This can give you the deep expertise at the higher levels, and a situation where much of the routine work is attractive to younger staff since it is new and offers exposure to things they have not experienced before.

Reporting lines

Within the overall organisation design, consideration needs to be given to the following:

- The breadth of the spans of control of individual people

and consequently the number of management levels in the organisation.

- Within a large tax function a balance is needed between providing an economical structure with no more levels of management than are really needed and one in which the number of people each person has to supervise is few enough to enable that person to give sufficient attention to each. It is particularly important for the head of tax not to have too many direct reports, so that they have time to deal with some of the bigger issues that should fall within their role.
- Clarity as to the areas of accountability of each position.
- The design of each individual job needs to set out a clear area of performance for which the jobholder is accountable. The job and organisation design should also, as far as possible, facilitate the jobholder's direct report in assessing whether or not the jobholder is performing the role to a sufficiently high standard.
- Mechanisms for facilitating collaborative working between different parts of the tax function where these are important for performance.
- A significant source of failure in organisation design is the establishment of structures in which it is assumed that particular organisational units and teams will work together collaboratively but in practice do not do so. Mechanisms for managing these interrelationships should be developed in sufficient detail to ensure that they will work effectively in actual practice. This will be particularly important for those tax functions designed around the tax specialisations or geographies.
- Adaptability to change.

The organisation design should take into account potential requirements for the tax function to adapt to organisational changes, such as changes in the company's tax strategy, mergers between business units within the company's portfolio or acquisitions.

At this point it is perhaps worth picking up a practical issue in relation to the decentralised model for a tax function. Where a member of the tax function is physically situated in a business line, and even more so where they are situated in a country other than the head office country, there will be a tendency for them to look to the local CFO as their direct report even if this officially is not the case. The question often comes down to who is responsible for their pay and benefits: if the local CFO is the person most closely involved, human nature dictates that the tax person will see this CFO as more important to them individually than the head of tax.

There is also the question of to whom the head of tax should report. In our opinion, the head of tax should have a direct report to the CFO (and should also have access to the board on a regular basis). We have seen a concerning trend in one or two places for the CFO to delegate tax down to financial controllers. We question whether this is appropriate. It is no surprise that while this approach remains in the minority, these companies seem to have a disproportionately high number of problems, especially controls weaknesses and resource issues, as compared to their peers. We are also aware of a number of cases where an organisation has a head of tax and treasury and in many cases this person's background experience is in treasury rather than tax. Again there can be a question as to whether tax is properly and fully represented at the senior levels of these organisation.

Biography

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Tony Elgood is an UK-based tax partner from PricewaterhouseCoopers' Global Compliance Services (GCS) team. He specialises in tax function best practice. He regularly speaks at conferences and has co-authored the new PwC Tax Function Effectiveness guide. Previously he had also written two guides on the subject: the PricewaterhouseCoopers' 'Best Practice' tax function and Tax Risk Management guides. He works with in-house tax functions, usually at a strategic level, helping them think through what they are want to achieve and how they best get there.

Flexibility

The tax function and the organisation of the tax function need to be flexible enough to cope with this change. We would therefore recommend, along with the overall tax strategy, that the organisation of the tax function is reviewed on a regular basis. Our recommendation is that the tax strategic plan should be reviewed and presented to the board at least once a year. We would suggest that the organisation of the tax function follows the same route to ensure that it is still appropriate.

There are a number of different roles within a tax function. Due to resource and budgetary constraints, there are usually rather less people within the tax function than there are specific roles to be carried out. This normally drives organisations to some sort of matrix structure whereby individual people have a number of different responsibilities.

We suggest that the matrix be based on one or more of the options we have set out above. One of the challenges for heads of tax is to consider whether the traditional structures that were based around the different taxes and different geographies are appropriate to today's best-in-class tax function.

Process or technology?

Thierry Morgant outlines some tax accounting and reporting issues

In recent years, technology has become increasingly important to the tax accounting processes of multinational companies, as well as in medium-sized groups with a number of affiliates. Even parameters with a limited number of affiliates have considered industrialised approaches to income tax, using some technology.

Focus on tax accounting is mainly attached to the complexity of the tax accounting process and increasing disclosure requirements under International Financial Reporting Standards (IFRS). In this respect, the continuing convergence between US GAAP and IFRS will most likely show itself in additional tax calculations and disclosure requirements for listed groups.

Having said that, experience demonstrates that in most situations technology is a plus but not the ultimate solution. Technology may affect tax efficiency, but some of the main difficulties in a tax accounting process may not always be resolved by technology. Although technology remains unavoidable for large organisations, it is important that tax reporting is defined in such a way as to understand how it applies to tax accounting and connects to existing or amended processes.

What does tax reporting bring to an organisation?

For those applying IFRS (similar to US GAAP), income tax positions are assessed under two different approaches at interim closing and at year-end. International Accounting Standards (IAS) 12 requires the full balance sheet liability method to be used for annual financial statements, whereas the projected effective tax rate (ETR) must be used for interim closing. These requirements entail significant changes in a group's working process depending on which is at stake and on the considered period (quarter or full year).

Annual process under IAS 12

The main driver for tax accounting under IAS 12 is the use of the full balance sheet liability method. In practice, this means that deferred taxes are determined as the tax effects attached to differences between the accounting and tax values of each item contributed to the balance sheet, and how those differences will reverse in the future (temporary differences). It is, therefore, groups need to be in a position to compare accounting and tax values in the balance sheet of each reporting unit or perimeter. This exercise, by its very nature, is extremely difficult and time-consuming.

In most cases, the comparison between IFRS values and tax values is further complicated by the fact that local tax values are based on local GAAP figures, which may largely differ from the IFRS figures. In such cases, it will be necessary to perform a two-step reconciliation between local GAAP and tax, as well as between local GAAP and IFRS. The net of these differences on each balance sheet item will then be categorised as temporary (giving rise to deferred tax effects) or permanent (potentially

creating a tax rate reconciliation item for those hitting the income statement). It follows that there is a need for further allocation in the systems to appropriately calculate and document the deferred tax positions.

After the balance-sheet approach has been fulfilled and the corresponding deferred tax effects have been assessed, there is an additional requirement for allocation of the net change of the period. Such change must follow the underlying basis (the temporary difference) to be recorded either in the income statement (most cases) or directly against net equity. For this exercise to be properly achieved, it is very useful to directly connect the deferred tax effect to the underlying basis.

Working process for interim closing

At interim closing, IAS 12 does not apply. However, it is replaced by IAS 34, which refers to the projected ETR methodology. Under IAS 34, an organisation shall determine its tax effects at interim closing by applying the annual forecasted ETR to the net income before tax of the period. It will subsequently amend the calculated tax charge to account for exceptional items of the period that were not anticipated during the forecast and which, by nature, should fully affect the considered period.

The outcome of the tax calculation at interim closing is therefore significantly different from the annual methodology under IAS 12 since: (i) it is a pure income-statement-approach; (ii) there is no distinction between current and deferred tax; and (iii) it is based on an annual forecast rather than on the actual performance of the group over the considered period.

By way of consequence, the tax reporting formats used for interim closing are affected by the GAAP difference in a very material way. The most practical approach will follow the IAS 34 requirements in two phases:

- projected ETR applied to net income before tax; and
- calculation of exceptional tax effects of the period.

Rather complex approaches can also be created to meet the financial reporting process of a particular organisation but will, in most cases, be close to that just described.

What the tax reporting will therefore maintain is a forecasted effective tax rate (that becomes increasingly important to the organisation) and a list of non-recurring exceptional items that the various entities have declared. At this stage, a discussion could follow about the parameters on which the projected ETR should be calculated and applied, as well as the nature of the exceptional items. However, this is more a technical than a process issue.

Reconciliations between interim closings and year-end

Upon application of IAS 12 and IAS 34, a few matters will also need to be addressed by most organisations to be in control of their tax positions.

Continuous review of cash tax positions

At each interim closing, the absence of distinction between current and deferred taxes makes it necessary to implement additional reporting requirements to follow up the treasury effects of income taxes. The calculation of the projected ETR may include the information based on a breakdown of the anticipated tax charge between current and deferred, giving rise to a ratio consistently applied throughout the year for management purposes. However, the cash tax position is a pure internal need for organisations and is not addressed by tax accounting literature from the regulatory bodies.

Reconciliation of the IAS 34 tax charge with the IAS 12 tax charge

Although using two different methodologies, pure theory would lead to the interim closing tax charge to be in line with that determined at year-end, and in any case it would not be materially different. This theory, of course, depends on the quality of the forecast prepared and used by the group. There are, in practice, many differences that can often explain a marginal difference, but it remains a priority of the tax team to understand and address potential differences, if only to avoid future differences.

For this reason, it is of high importance that both processes can ultimately be compared, which will often be a complex exercise if not dealt with by an integrated solution where all data is available in similar formats and can be prepared for comparison. In this environment, a tax reporting tool brings value to the tax accounting process of an organisation, and in a large organisation it probably is critical for financial reporting.

What is needed behind tax reporting?

The benefits of a tax reporting tool have been widely demonstrated in recent years, and now it begins to be obvious that technology will remain a need but will not be the ultimate solution to all tax accounting problems.

Some of the organisations that implemented tax reporting tools initially had the strong desire for a push-button solution where a vice president of tax could, from his or her central office, print reports that would make tax accounting look smart and easy with no (or limited) human involvement. This would have been achieved through a full connectivity between the various information systems used by the organisation from the enterprise resource planning(ERP). There, tax data would have been flagged properly for tax purposes to the tax returns where temporary and permanent adjustments would be easily identifiable. Unfortunately, this was extremely complex for several reasons including technical matters, internal work methodology of the groups, variety of IT systems, changes in tax legislations and formats and so on.

Main drawbacks to fully-automated tax reporting

First and foremost, the consolidation process now applied by

most organisations tends to directly run the accounting of the group under the consolidation GAAP (US GAAP or IFRS), having local GAAP financial statements prepared annually only and after the consolidated accounts have been finalised and published. As such, local GAAP information is commonly not available at the time tax accounting positions are determined. Therefore, the identification of temporary adjustments cannot be prepared automatically and will require manual input by local teams.

Depending on the territories where IFRS are either accepted or denied as the accounting basis for local taxation, this will increase the process to be followed by the system to determine tax accounting positions. One might also consider that many options are available when determining a taxable income and a current tax charge, which cannot be automatically mapped into an IT system. In this respect, it is worth noting that a tax reporting solution will not only allow the documentation of deferred tax positions but must also document current tax effects (without this the understanding of the global tax position would be impossible). For these among other practical reasons, automated tax reporting solutions will likely not be fully efficient for another period of time, at least in the medium term.

Suggestion of tax reporting appropriate process

Two different levels can be considered for improvement in tax accounting processes, with different benefits to an organisation:

- the first area is for IT to bring value to the data collection for preparation of the balance sheet reconciliation (or identification of the exceptional items affecting the IAS 34 calculation); and
- the second area is the consolidation of tax accounting information and documentation of historical positions in a data warehouse for immediate or future use.

For a data collection to be performed automatically by a tax reporting tool, it requires large changes and modifications in the formats used by a group to record accounting and tax entries. More importantly than that, there is ultimately a strong disconnection between the tax accounting work for annual financial statements and the tax life of a group where the tax strategy focus is expressed in the tax returns. When both processes become exclusive or separated from each other, it may trigger additional difficulties in the life of the group and may ultimately embody errors from miscommunication.

Finally, it is in very specific situations that the adjustments recorded in the worldwide tax returns of an organisation would possibly be tracked by an IT system and properly categorised as temporary or permanent for deferred tax purposes. These situations, although theoretically conceivable, would be non-existent in practice.

Therefore, one of the key questions when looking at a tax reporting tool is to assess the level of automation versus the increasing difficulties in implementing it to have it function effectively over time. There are also several matters that are subject to judgment, such as the recognition of deferred tax assets. These will never be achieved by technology. From experience, the identification of tax adjustments, either current or deferred, should remain a manual exercise in the tax accounting process.

When it comes to calculations, consolidation of information, documentation, historical track records or preparation of reports and central analysis, a tax reporting tool is clearly of full benefit and efficiency. In a 2006 *International Tax Review* supplement (Issue 29, *Tax Management in Companies*), we discussed the benefits attached to tax reporting tools such as management of perimeters, ETR reconciliation, and currency translation adjustments. These, of course, remain applicable and have demonstrated their effectiveness over the past two years, as previously indicated.

What has significantly improved with the implementation of tax reporting tools is the ability of organisations to enter into structured tax accounting processes with local documentation and review supporting an efficient use of a centralised IT solution for the reporting of income taxes. Changes in the work methodology have been achieved, bringing value to the groups and facilitating the use of tax data at all levels (local, regional and central) and in all respects (determination of tax effects, documentation of positions, anticipation of tax costs, planning and so on). From experience, this second area is the key for current tools and is the area where advances can be made.

Efficient organisation around tax reporting tools

In addition to having an efficient tax reporting tool, groups will need to develop or strengthen their tax accounting skills and implement detailed processes to ensure that all actors in the organisation are properly contributing to quality financial statements. In the tax world, tax accounting is at the frontier between tax, accounting and finance. It requires a fair understanding of IFRS or central GAAP and of local tax rules as well as a general accounting knowledge. It also becomes increasingly important to benefit from financial knowledge to understand complex structures and consequences in cases of acquisitions, management of goodwill and associated tax effects or specific transactions such as leases or share-based payments.

A common error linked to the implementation of tax reporting tools is the assumption that the new formats and increased technicalities will improve a particular situation. Actually, the change will bring attention to further matters but will not resolve them unless a productive environment is created to allow for resolution of issues by management.

The typical situation in a number of organisations is that local individuals are responsible for the assessment of tax

accounting positions and reporting to the group. Changing the tool used for the reporting will not in itself improve the ability of such individuals to achieve a correct assessment of the tax positions. Hence, when a group implements a tax reporting tool, at least two actions should be taken so that the tool will be used appropriately:

- development of a tax accounting methodology consistent with the tool; and
- training of resources and maintenance of training for new personnel.

The methodology piece is critical, assuming that resources in the group have a general understanding of tax accounting matters. It will involve all parties in the tax accounting world, from IT to GAAP technical departments, accounting, finance, consolidation and tax. In practice, different methodologies can be implemented depending on the group structures and existing skills, with more or less emphasis put on local versus central work. Methodologies will generally follow the annual calendar and accounting deadlines of the organisation and ensure that all reconciliations are performed by the appropriate due dates to facilitate the overall process. The process should clearly allocate workloads and responsibilities by departments and, ideally, by individuals, including cooperation among the various teams.

As anticipated a few years ago, tax reporting tools and technology in the tax world have become necessary. Complexity of tax accounting and implementation of IFRS on a global basis are facilitators of a standardised tax accounting to meet GAAP requirements. In this respect, there are several efficient methods that can be taken by groups, none of them being a plug-and-play solution to the existing functions. Successful tax reporting projects have required detailed analysis of the existing tax function (including the "shadow tax" function, defined as all individuals in an organisation contributing to tax numbers without clear reference to a tax position) and of the existing tax accounting processes to ensure the efficient use of improved technological tools.

Biography

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Michael Frigo, PricewaterhouseCoopers
Switzerland

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