The unique challenges facing US inbound companies

By Joel Walters

The author give special thanks to Clyde McCarter.

Tax departments around the world are facing growing demands to do more with fewer resources. Joel Walters, inbound tax leader for PwC US, explores how in-house teams can successfully navigate the new corporate tax landscape in light of increased scrutiny on tax planning processes, reporting requirements, and compliance initiatives.

March 2014

This article was originally published by International Tax Review.

Technology is increasingly being used to ensure tax personnel are connected globally

It's not news that today's corporate tax function faces more and more challenges. The constant demand to increase productivity is virtually a cliché, and the ever-escalating regulatory burden coupled with tight budgets, unprecedented demands for information from taxing jurisdictions, and the high threshold to consistently produce timely and accurate tax compliance and financial accounting all contribute to a difficult operational environment for tax departments around the world. Overlay this with the increased scrutiny on the tax affairs of multinational businesses and it is clear that the demands have never been greater, and continue to grow.

"Tax departments are being asked to do more with either flat or fewer resources in an environment where there's no room for error," ex plains Ken Kuykendall, PwC's US Tax Reporting and Performance Improvement Leader.

In their quest to overcome these hurdles, tax departments often face internal barriers as well. Access to quality data, heavy reliance on complex spreadsheets, inefficient data collection processes, and sometimes even less than ideal collaboration with other parts of the business all contribute to today's challenging landscape for tax executives.

pwc

Kuykendall suggests that while other portions of the business are continually enhancing access to real-time, high-quality information through the use of technology and knowledge management systems, "tax departments are often behind the curve on this which can lead to inefficiency, and at times costly errors and missed opportunities".

US subsidiaries of foreign companies (inbound companies)

Inbound companies often have unique challenges in respect to tax planning, risk management, and compliance. Doing more with less and using technology to optimise and enhance delivery are two themes many US inbound companies face, creating a situation in which greater demand is placed on the US tax departments than in other territories due to the complex and extensive US tax system.

US tax departments of inbound companies often need to work harder to capture and retain the requisite budgets and resources, as well as to influence the technology agenda in a way that enhances their ability to perform at the level demanded.

Looking to the tax department benchmarking work being done within the US inbound community by the Organization for International Investment (OFII), we can see some clear evidence of this landscape. For ex ample, despite the increasingly demanding environment, respondents to the survey suggested that for most US tax departments, headcount and/or budgets are expected to remain constant (66%) or decrease (1 8%), whereas only 16% expect to see an increase.

Interestingly on the technology question, the benchmarking data was particularly telling in that it suggested that key technology solutions were only being used or contemplated in 32% of the respondent companies for compliance and 25% for provisions. When contrasted with the fact that nearly 50% of the respondents said that more than half of their people resources were allocated to compliance; this paints a very labour-intensive picture where enabling technology is frequently absent.

Making the case for investing in the US tax department

The inability to meet today's challenges can result in internal control deficiencies, financial restatements, and in some extreme instances a general loss of confidence in the tax function and the company itself. Plus, to the extent that resources are stretched to deal with compliance and other mandatory risk management activities, it limits efforts to focus on more discretionary activities such as planning and advocacy, with the loss of material potential upside benefits. Yet, over recent years, the experience of many tax executives has been that there is mounting pressure to rationalise headcount and operating budgets.

When turning the focus to inbound companies, the resourcing and budgeting hurdles can be increased for a number of reasons. Principal among these can be a lack of appreciation at the parent company as to the level of compliance burden in the US where the federal mandates alone can greatly exceed those of most other jurisdictions, even before adding in state and local obligations. When the headcount in the US tax department materially exceeds that of all other territories including the parent location, which can often be the case, the push-back can be more difficult to defend.

In addition, US tax departments of inbound companies can be hampered in their ability to make the budgeting case by mixed reporting lines. The OFII benchmarking suggested that 44% of US tax functions reported to the global tax function while 40% reported into the US CFO, with 1 6% reporting into other global or local functions. This can make the road to achieving investment in the US tax department less clear, especially since 66% of respondents said that after-tax measures were not used in compensation or in measuring business unit performance.

First published in the March 2014 issue of International Tax Review.

Reprinted by permission.

Technology

The search for solutions has led many tax professionals to realise that technology can significantly aid in the effort to maintain or improve their effectiveness.

"The benefits accruing from the use of technology is the reason we specifically investigated this area in a second set of questions in the benchmarking survey after seeing the initial data we gathered from our members," says Abigail Martin, OFII Vice President, External Affairs.

Yet, as mentioned above, the use of technology, especially in the compliance and financial accounting areas, is less prevalent than might have been anticipated. While there may be aspects of this reluctance to leveraging technology which might relate to unique aspects of inbound companies, it mirrors similar reactions globally , as tax executives generally have encountered significant resistance when seeking budgets for tax technology investments sufficient to make a meaningful impact on tax function effectiveness.

But while inbound companies are likely not encountering materially greater resistance to capital expenditures for technology focused on the tax function, there are aspects of inbound companies that do make dealing with the related issues different.

One approach to leveraging technology is to utilise effectively the infrastructure already embedded in the broader finance organisation. Automating tax operations by integrating well-established tax tools, such as compliance and tax accounting systems with financial reporting source systems can substantially reduce the effort to collect, manipulate, and validate data. However, due to the existence of legacy systems and infrastructure, subsidiary organisations like the US frequently rely on platforms and systems different from those of the parent company. This can mean that information necessary for the tax function is buried within varied systems.

One not uncommon result of this is a spreadsheet-based technology environment, with mission-critical, complex spreadsheets typically dependent on a single user and lacking an audit trail, as well as quality and version control.

When looking for existing technology assets within the broader organisation, a good place to begin is within the company's enterprise resource planning (ERP) system and related modules. Most finance departments have invested heavily in their ERP systems but with little input from the tax side. The OFII benchmarking results showed that 54% of foreign companies with US-based tax activities are leveraging to some ex tent their ERP systems for data needs. Another 21 % are actively looking to increase such use.

The difficulty is that "we often find tax organisations have not properly configured their existing ERP or related modules to automate extraction of information needed for tax reporting and planning. The use of extract, transform, and load (ETL) tools and business intelligence (BI) platforms to eliminate manual processes is often overlooked," says Kuykendall.

"In my experience, once the concrete for the ERP system is poured it is very difficult to change it, so, without complete engagement in the design and implementation phase, the result can be suboptimal, and at times even the parent company tax department is not sufficiently engaged during these critical times, let alone the tax departments in subsidiary territories, such as the US, resulting in a huge missed opportunity and likely future frustration," adds Kuykendall.

Efficiency dividend

Viewing this area as an opportunity as opposed to merely a risk, having the time to perform more and better analytics is the value associated with realising an efficiency dividend.

First published in the March 2014 issue of International Tax Review.

Reprinted by permission.

Free up staff

Efficiency gains via technology can reduce the hours required to complete tasks by 10-20%. Most tax functions are redeploying that newly created capacity to high value tasks such as risk management, planning, financial reporting, and controls.

Improve quality of information

Using technology enables a higher level of accuracy and faster access to book data directly from source systems worldwide.

Increase analytics

Having more time available to perform analytics rather than data collection provides significant value to the business.

Connect tax personnel globally

Many material weaknesses attributed to the tax function relate to matters emanating from outside the home country. Technology is becoming increasingly important to close the gap.

Strengthen internal controls

When done correctly, implementing new technology includes the design and implementation of new processes. The result can be a much improved control environment evidenced by new processes supported by enabling technology.

Improve forecasting capability

Accurate forecasts of the effective tax rate and cash taxes are critical to the effective management of tax. The emergence of more advanced tax accounting software, as well as sophisticated modeling and analytic software, now makes it much easier to report on, model, and forecast ETR. In addition, closing the gap between the tax accounting system and the ERP to collect the most current data is another critic al technology element enabling better tax forecasting.

The way forward

By shaping the case for investment into the tax department generally, while understanding the way this can and should be approached differently from other parts of the global tax organisation, will make for a stronger position and access to more focused resources that might otherwise be unavailable.

The technology challenge represents an opportunity for tax functions to reduce time spent on data collection and manipulation, as well as achieve technology and process improvements, including leveraging existing investments in enterprise systems.

Further, there can be no doubt that most US tax departments of inbound companies can gain significant financial benefit by embarking on a well thought-out tax data management plan and create value by realising an efficiency dividend.

"While we are seeing pressures on tax departments across all organizations, the work we have done with our members makes it clear that there are specific challenges for inbound companies. We hope to continue to work with our members to identify and assess those challenges, as well as identify opportunities to approach these issues in a fully informed way to optimise results," says Martin.

First published in the March 2014 issue of International Tax Review.

Reprinted by permission.