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Tax Function Effectiveness

Unlocking value from the Tax function in Nigeria's Financial services

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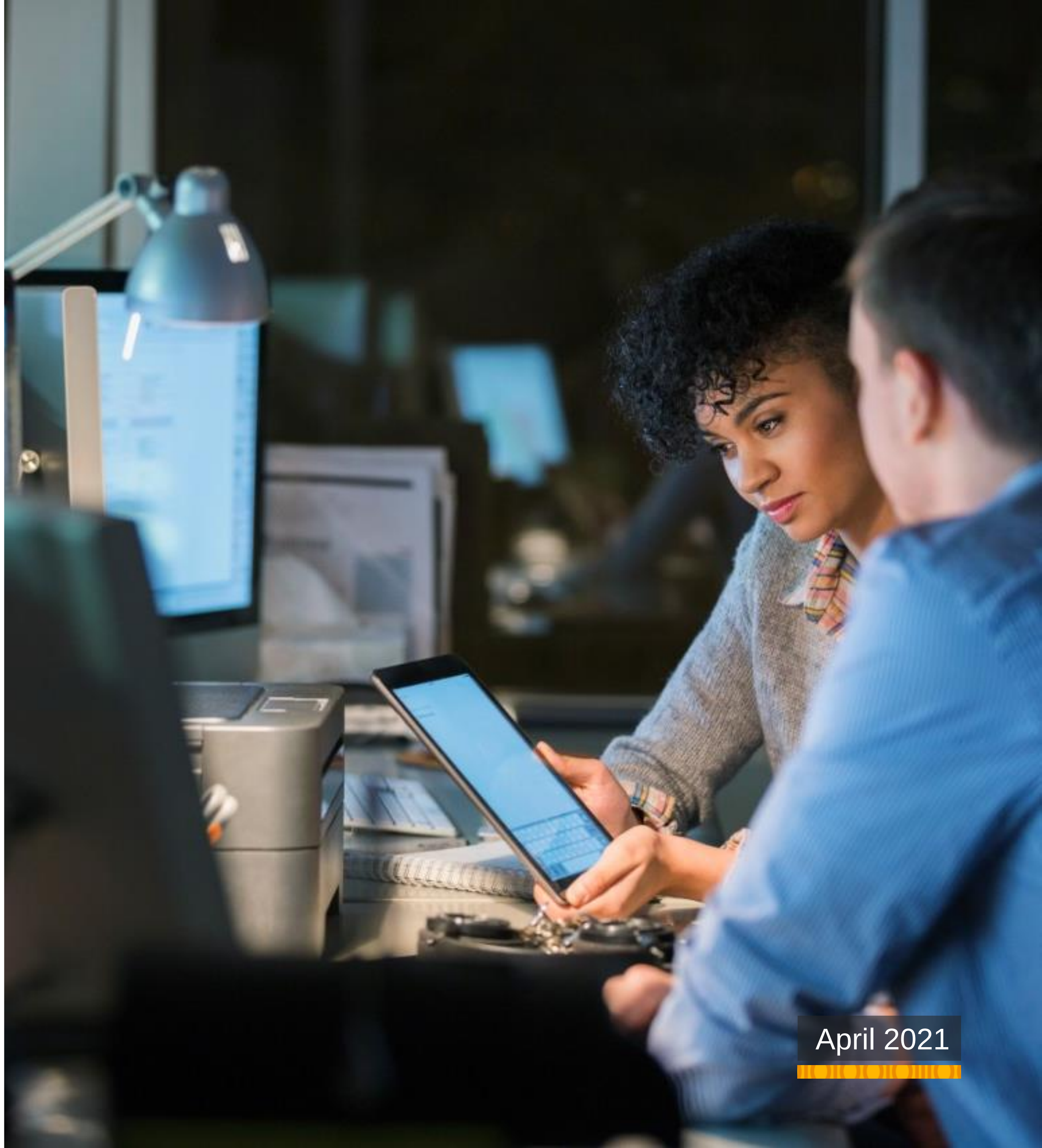

April 2021

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Introduction

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Introduction

The highly dynamic local and global tax environment requires a careful examination of today's tax function. Tax functions may need to change to better manage risks, address capability gaps, and create value for their organisations. The process of change poses a challenge for many organisations. Those in the Nigerian Financial Services (FS) Industry are not left out.

The aggressive nature of revenue-generating agencies places greater responsibility on the tax function like never before. The revenue authorities' actions constrain the tax function, often reducing it to a compliance-focused unit rather than a potential strategic partner in its corporate vision and business strategy.

In this survey, we polled major industry players in the Nigerian FS Industry and analysed their responses. This report highlights the various areas that may be impeding the tax function's transformation target with recommendations on steps to take in order to achieve an optimal tax function.

Industry Overview

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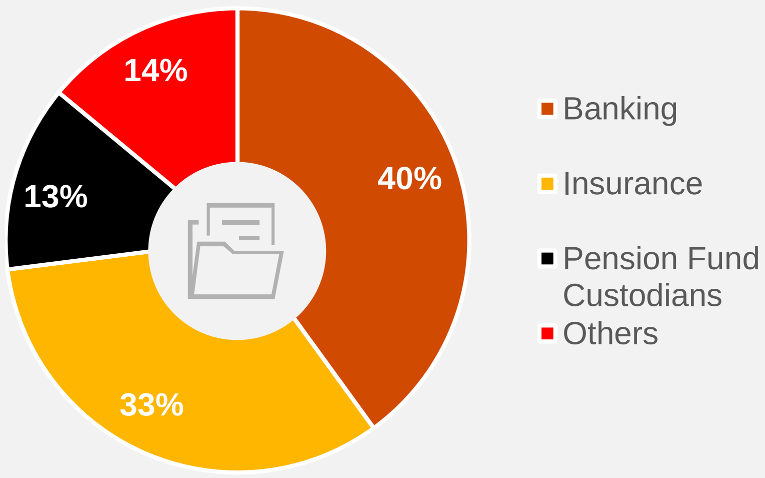
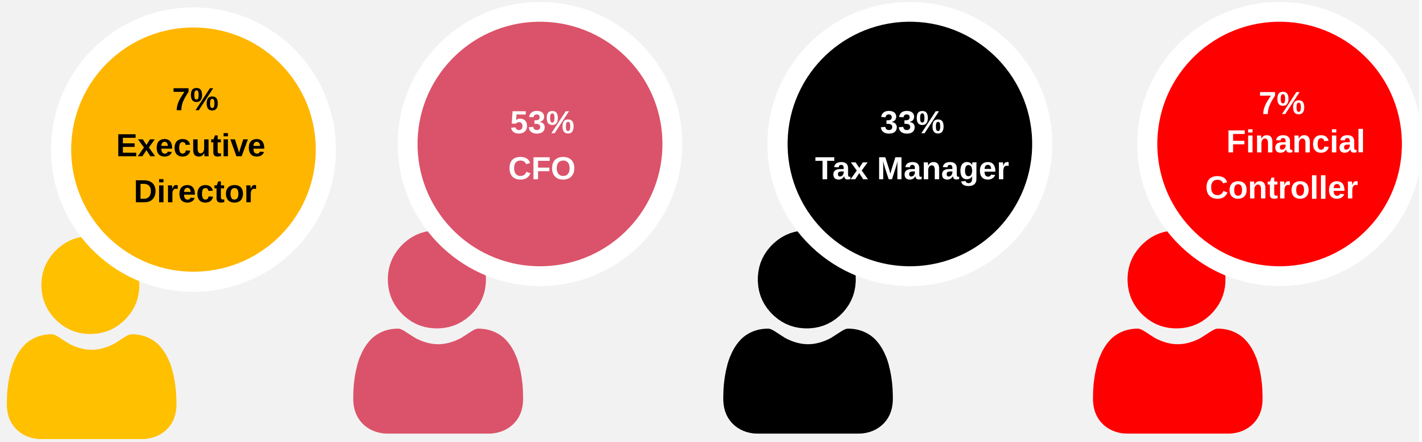
Sub-sector and Designation of respondents

Respondents were senior level executives from various sub-sectors within the Nigerian FS Industry.

The Banking sector, the largest sub-sector in the Nigerian FS Industry, made up 40% of the respondents. It was closely followed by the Insurance sector, a growing sub-sector within the FS Industry, at 33%. Pension Fund Custodians sector constituted 13% of the respondents.

Executive Directors and Chief Finance Officers (CFOs), combined, made up 60% of the respondents. Tax Managers and Financial Controllers also responded to the survey at 33% and 7% respectively.





Source: PwC analysis

Current state of tax functions in the FS Industry

The tax function is constantly evolving, depending on the strategic objectives of the organisation.

Based on the survey, organisations in the FS Industry, especially the Banking sector, are moving towards creating fully fledged tax functions that are staffed with about 5 employees in their tax unit.

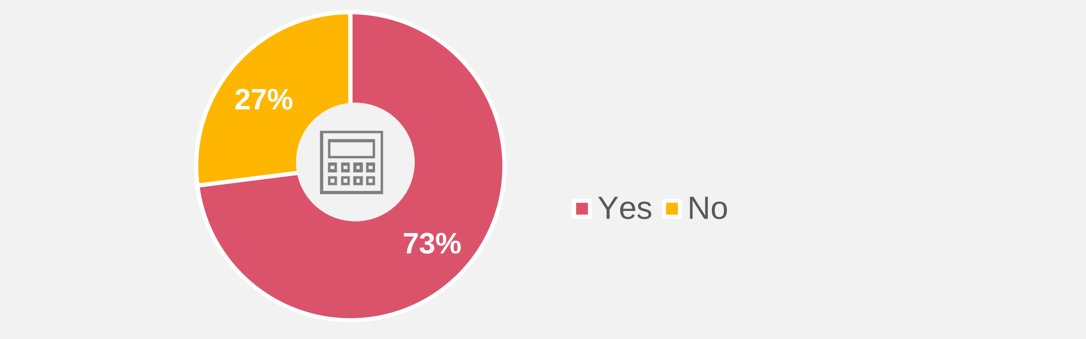
The evolution of the tax function seems to be driven by the complexity and volume of transactions. Other factors could also determine the structure of the tax function, including, but not limited to, the cost versus the benefits of having a tax function and the possibility of automating most of the tax processes and keeping a lean function.

Key Takeaways

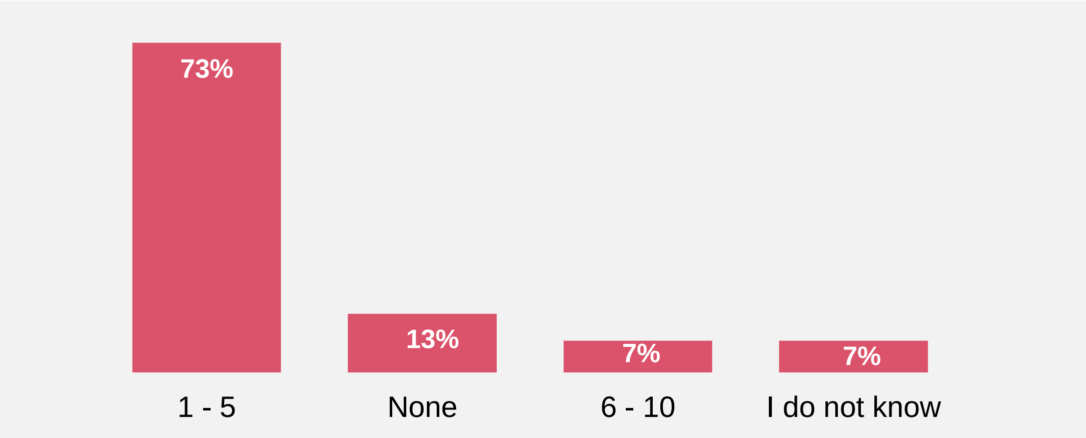
As an organisation goes through the journey of creating a fully fledged tax function, it is important that they consider how optimised their tax function is, as well as identify possible processes that could be outsourced or insourced.

In the future, the structure of the tax function will change depending on the type of organisation. Reorganising the function around tasks that refocus the energy of employees towards more strategic processes would define a successful tax function.

Do you have a tax function?



Size of your tax function?



About half of tax functions do not have a documented tax strategy/tax policy

47% of tax functions either do not have a tax strategy or are not aware of one.

A little over half of the respondents (53%) say that the organisation they work for has a documented tax strategy. 27% of respondents, say that the organisation they work for does not have a documented tax strategy, while 20% of respondents are not aware whether or not their organisation has one.

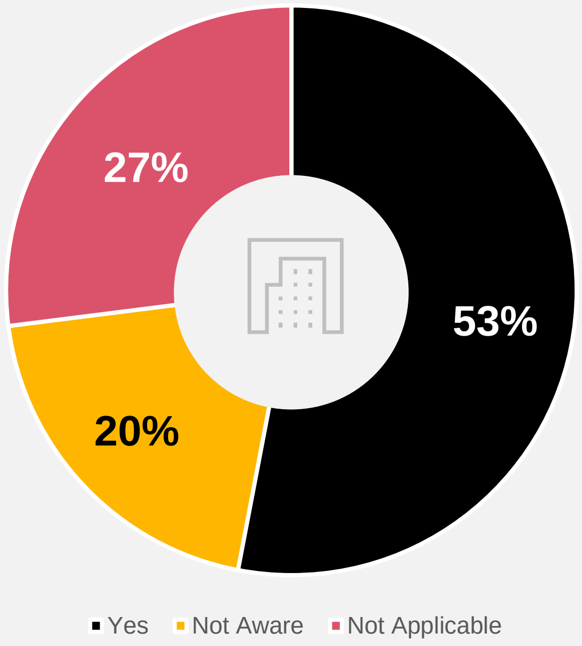
Key Takeaways

For a function which is supposed to drive value in the organisation, our survey revealed an absence of a clear strategy for nearly half of tax functions in the Nigerian FS Industry.

Majority of organisations in the Nigerian FS Industry may have a fully resourced tax function, but some may have been set up without a documented tax strategy.

Tax as a function should have a documented strategy that aligns with the overall business strategy.

Does your organisation have a documented tax strategy/tax policy?



Tax usually has little involvement in Enterprise Resource Planning (ERP)/Software deployment

An overwhelming majority of tax functions are not compulsorily involved in ERP/software deployment

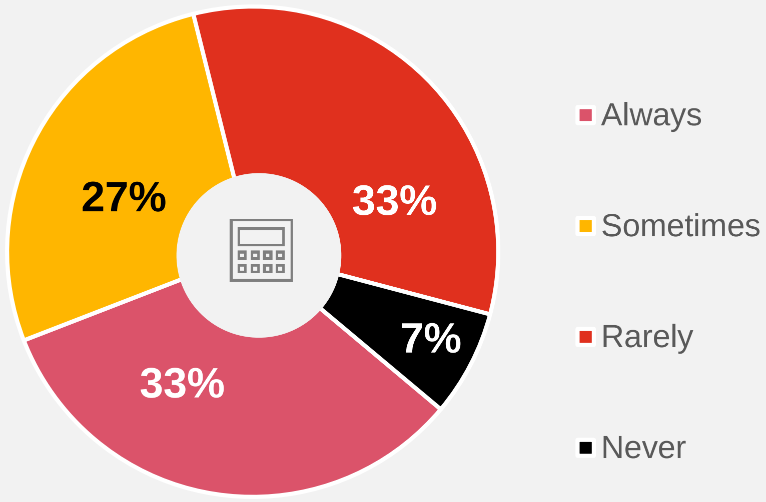
About 67% of the respondents say that they are either sometimes, never or rarely involved in ERP or software deployment.

Key Takeaways

The tax function is one of the biggest consumers of financial and non financial data due to the increased demand brought about by multiple compliance and reporting obligations. The new global regulations around tax transparency and collaboration among tax authorities such as Foreign Account Tax Compliance Act (FATCA), Country by Country Report (CbCR) and Common Reporting Standard (CRS) have amplified the demand.

The increased compliance and reporting obligations have made it imperative for the tax function to be involved in ERP development in order to eliminate the negative impact caused by time consuming manual processes, labour-intensive data collection that is prone to errors.

How often is tax involved in Enterprise Resource Planning (ERP)/Software deployment?



Source: PwC

Tax functions not involved in the development of new business or product lines

For nearly half of the organisations surveyed, getting the tax function involved may be an afterthought when it comes to innovation and product development

About 74% of tax functions surveyed confirmed the lack or limited involvement in strategic tax planning and making their organisation's products more tax-efficient, both for the customers and the tax outcomes for the business.

Key Takeaways

The tax function needs to be more involved in the making of strategic decisions and planning rather than being involved after the decisions have been made, which could be very costly to unwind.

When making significant changes to the business's operational structure, such as product development, restructuring, new business lines, etc; organisations need to ensure that the tax function is involved in the entire process.

How involved/embedded is the tax function in business operations and the development of new business or product lines?

Source: PwC Analysis

Tax risks faced in the FS Industry in Nigeria vary in order of importance

Organisations in the FS Industry face increased likelihood of unplanned financial losses in their operations

Based on the survey, exposure to additional tax assessments and lack of automated tax processes rank as the key concerns that most tax functions have to deal with.

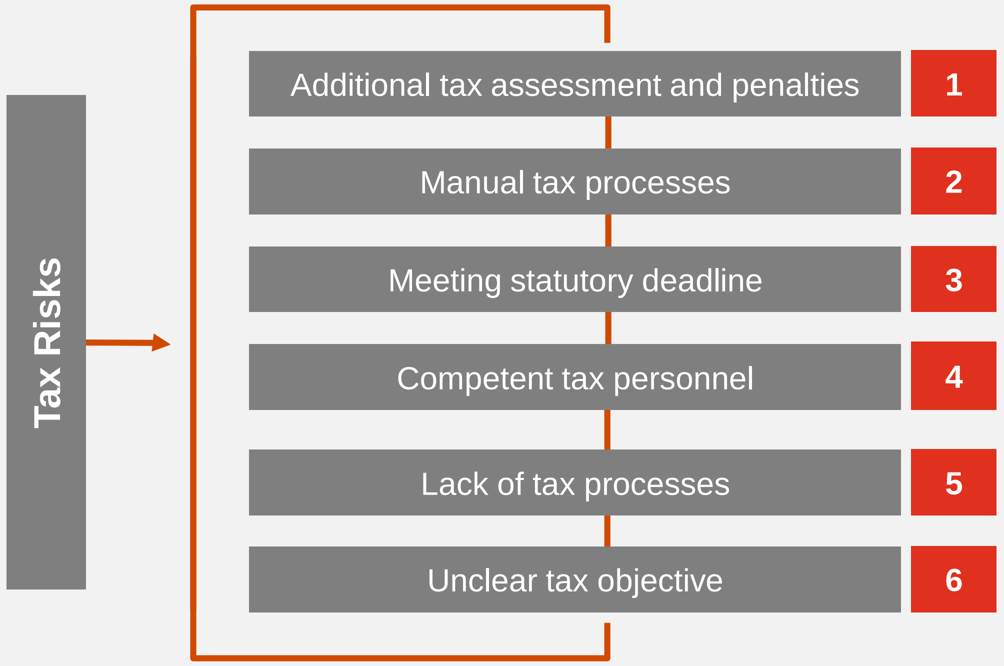
Key Takeaways

The FS Industry is characterised, among others, by high volume of transactions, manual tax processes and operations that cut across multiple locations.

This makes organisations operating in the FS sector prime targets for tax administrators and regulators thereby exposing them to additional tax assessments from the multiple audits.

Managing tax risks is increasingly becoming less technical. It requires the tax expert to be strategic and possess skills such as technology awareness, innovation, cross-industry knowledge, etc.

Tax risks and order of importance:



Source: PwC Analysis

Tax-related Key Performance Indicators (KPIs)

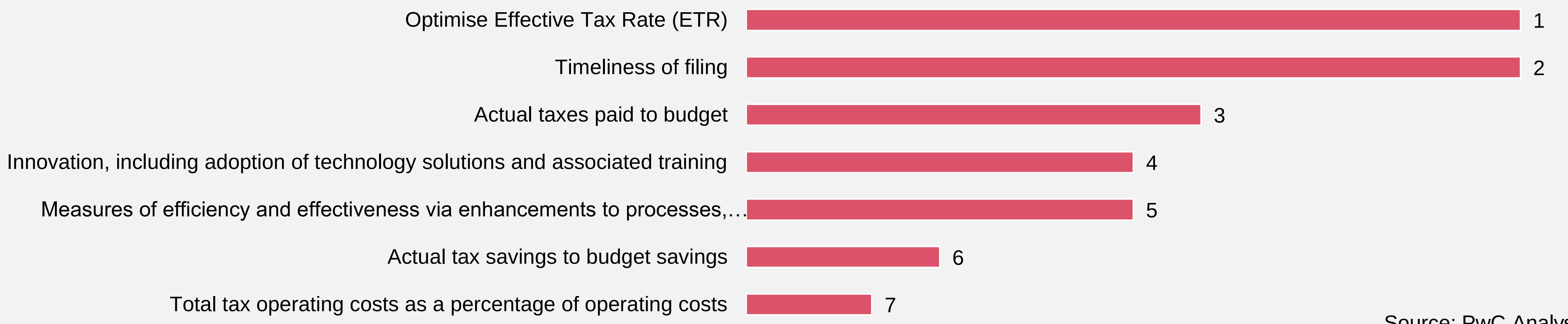
As a budding strategic partner in achieving the firm's overall corporate goals, the Tax Function also measures its performances in some critical areas.

Tax Functions in the FS Industry monitor the listed tax related KPIs in the graph below closely because it would likely cause severe losses or outright failure when not adequately monitored. The survey shows that "optimizing Effective Tax Rate (ETR)" and "Timeliness of filings" were considered as the most important KPIs for the tax function.

Key Takeaways

Our survey reveals a misalignment between the priority of risks and some of the tax function's KPIs. ETR, for instance, is an income tax ratio; meanwhile, the main threats, based on our survey, are around transaction taxes, such as Withholding Tax (WHT) and Value Added Tax (VAT). Thus, if a strategy is not driving a business's KPIs, it ends up setting defective KPIs.

Tax risks and order of importance:



Source: PwC Analysis

Areas of possible additional tax exposures during tax audit

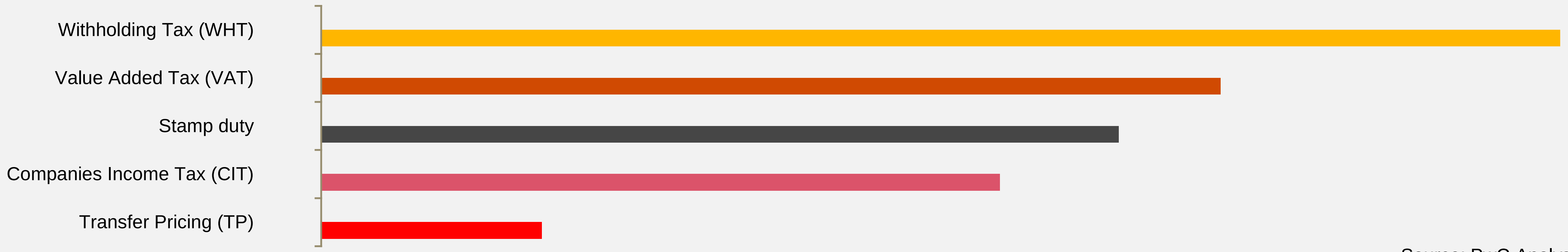
In relation to tax audits, some taxes pose greater likelihood of leading to additional tax liabilities/significant exposure than others.

From our survey, transaction taxes such as WHT and VAT are high up the list of taxes with a greater probability of leading to additional tax liabilities/significant exposure concerning tax audits.

Key Takeaways

Transaction taxes such as WHT and VAT are high up the list of taxes with a greater probability of leading to additional tax liabilities/significant exposure to tax audits. Not unusual for an industry characterised by high volume of transactions, multiple locations, and prone to tax risks with manual tax processes. Other taxes, based on their level of impact, are stamp duty, Companies Income Tax (CIT), and Transfer Pricing (TP).

Our findings show that many organisations in the FS Industry do not have sophisticated and robust technologies to manage transaction tax risk exposure efficiently. Despite they knowing the various tax regulators make specific requests each tax audit cycle.



Source: PwC Analysis

Low technology adoption for tax compliance

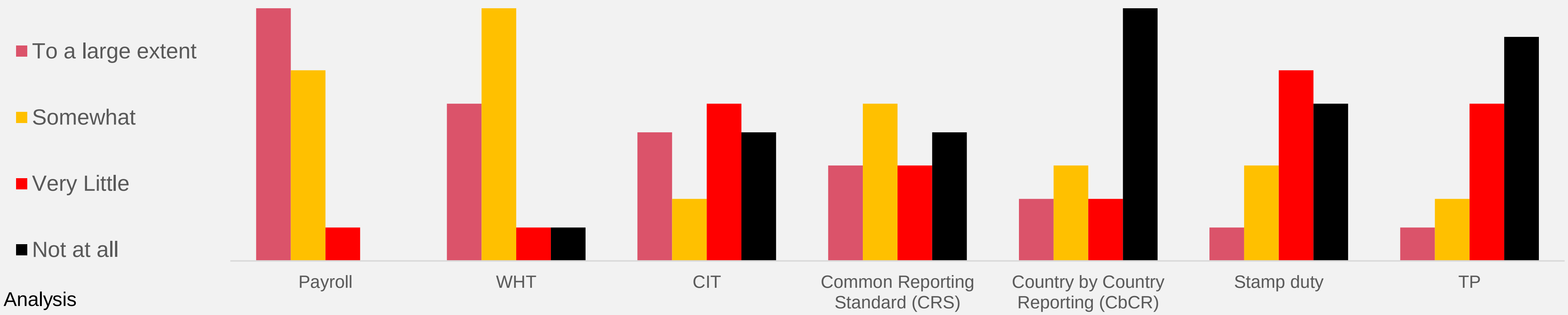
In spite of widespread technology adoption in managing several aspects of operations in the Nigerian FS Industry, technology is yet to be leveraged in managing taxes.

Only in managing payroll has technology been widely adopted for tax compliance. Other taxes such as CbCR, TP, Stamp duty, CRS are new areas of focus, and most tax functions may not have gotten around getting technology to deal with them, although that option is available.

Key Takeaways

Organisations may not have thought that it is possible to automate their CIT, preferring to stick to manual computations' status quo. Invariably, CIT computation often seems to be a material focus for tax functions. However, CIT could be automated when there is logic to the computation process.

Though WHT seems to be one of the highest tax exposure areas, it is clear that organisations in the FS Industry lack a robust technology system in
managing it. It is important to note that applications are available to automate the WHT compliance process to free up the tax function of
time-consuming manual exercise.



Source: PwC Analysis

Banking Sub-sector

A closer look at one of the FS Industry's key players

3

Banking sub-sector Highlights

The Nigerian banking landscape is well-developed and relatively competitive, consisting of an array of local and international banking and financial institutions. Tax functions in the banking sector are receiving more attention as organisations move to align their processes with global best practices.

The Economist Intelligence Unit (2020) forecasts the volume of mobile-payment transactions to continue to rise rapidly over the next few years. As the volume of transactions continue to rise, embedding the tax processes would save organisations from potential threats that arise from volume of transactions among others.

We summarise key highlights from the banking sub-sector as revealed in our survey, focusing on the structure of the tax function, rate of technology adoption, involvement in business development and key performance indicators (KPIs).

Key survey highlights in the Banking Sub Sector

Structure

The banking sector is moving towards a fully resourced strategic tax function as our survey shows 100% adoption rate of a separate tax function compared to 73% for the FS Industry.

Strategy

Having a tax strategy to drive the goals and objectives of the tax function is crucial to organisations in the banking sector. 100% of respondents say their tax function has a well documented tax strategy, well above the industry average of 47%.

Involvement in Business Development

Despite sector-wide adoption of a separate tax function with a clear tax strategy, an overwhelming majority of organisations (67%) do not involve the tax function in business development.

Technology adoption

Our survey reveals that, only in managing Payroll has technology been adopted among firms in banking sector. Other equally important tax obligations, such as WHT, CRS, SD, CbCR, CIT & TP, are mainly manually driven, our survey shows.

KPIs

Timeliness of filings is one KPI common among 100% of organisations surveyed in the banking sector.

Other KPIs, considered by at least 67% of organisations surveyed in the banking sector, are:

- Optimise Effective Tax Rate
- Actual taxes paid to budget
- Measures of efficiency and effectiveness via enhancements to processes, workflow, documentation, and collaboration
- Innovation, including adoption of technology solutions and associated training.

Actual Tax savings to budget savings and total tax operating costs as a percentage of operating costs, however, were only a critical success factor to 33% and 17% of respondents respectively.

Insurance Sub-sector

4

Key survey highlights in the Insurance sub-sector

According to The Economist Intelligence Unit (2020), although Nigeria's insurance sector contributes little to the national economy, it has the potential to grow quickly. The insurance sub-sector could benefit from greater level of product innovation, consumer awareness and operational oversight.

Fitch Ratings (Q4 2020) forecasts that Nigeria’s insurance sector will enjoy a period of growth and development over the medium and long term, albeit interrupted by a slower pace of growth in 2021 due to the effects of the coronavirus pandemic. An optimised tax function is crucial in achieving forecasted growth and development.

A summary of key findings from our survey is presented on areas such as the structure of the tax function, strategy, the rate at which the tax function is involved in business development and key performance indicators (KPIs).

Key survey highlights in the Insurance Sub- sector

Structure

Organisations in the insurance sub-sector may yet to see the need for a separate tax function.

Our survey showed that majority of organisations (60%) in the Insurance sector do not have a tax function. Just 27% of organisations in the FS Industry do not have a separate tax function.

Strategy

Considering the fact that a majority of organisations do not have a tax function. It's not a surprise that the number of organisations without a documented tax strategy in the insurance sub-sector is 80% compared to 47% in the FS Industry.

Involvement in Business Development

Participation of tax functions in business operations and the development of new business or product lines is nonexistent; 80% of respondents say they are sometimes involved, the rest are rarely involved in their firm's innovation process.

Technology adoption

Our survey reveals that there is a low technology adoption rate in managing some of the most common taxes by organisations in the Insurance sector.

Only 20% of respondents said they leveraged technology in managing both payroll and WHT. All the respondents indicated that they do not leverage technology in managing other taxes such as TP, CIT, CRS, CbCR and Stamp duty.

KPIs

Major KPIs in the Insurance sector:

- Optimise Effective Tax Rate (ETR)
- Timeliness of filings
- Actual taxes paid to budget

Other KPIs include:

- Total tax operating costs as a percentage of operating costs
- Innovation, including adoption of technology solutions and associated training

Two KPIs, though monitored in the FS Industry, are not considered critical success factors in the Insurance sub-sector. They are:

- Measures of efficiency and effectiveness via enhancements to processes, workflow, documentation, and collaboration
- Actual Tax savings to budget savings.

Recommendations & Conclusion

5

Recommendations

01

Align tax strategy with business strategy

Tax function first needs to establish a comprehensive strategy for the function that is aligned to the overall business strategy. Based on the business' objectives, Tax can make decisions that focus attention more directly on the key factors that best drive success. A tax strategy aligned with business strategy significantly reduces reputational risk and tax disputes.

02

Set KPIs defined and driven by metrics

With a documented tax strategy, processes and existing measures should be assessed to ensure ability to determine performance and success in the identified areas. Setting appropriate KPIs that reflect the business strategy allows the organisation to identify gaps between actual and desired results, leading to a more accurate evaluation of the effectiveness of its strategy.

03

Innovation processes should occur with significant participation from Tax

The tax function should be involved in its organisation's innovation process and other major changes to guarantee its ability to meet local and/or global compliance obligations. It helps organisations avoid potential pitfalls and missed opportunities. Participating in every step in the process also drives overall operational effectiveness for the organisation and the tax function.

04

Deploying an integrated solution

Tax functions need to re-evaluate how data and related documents are received, processed, and retained while adding value through strategic decision making. Tax functions should focus more on data mining for deep insights and also leverage technology for efficiency. According to a PwC's client satisfaction survey, document management and electronic workflow of tax processes saved time, increased efficiency, and led to improved controls for 83% of respondents.

05

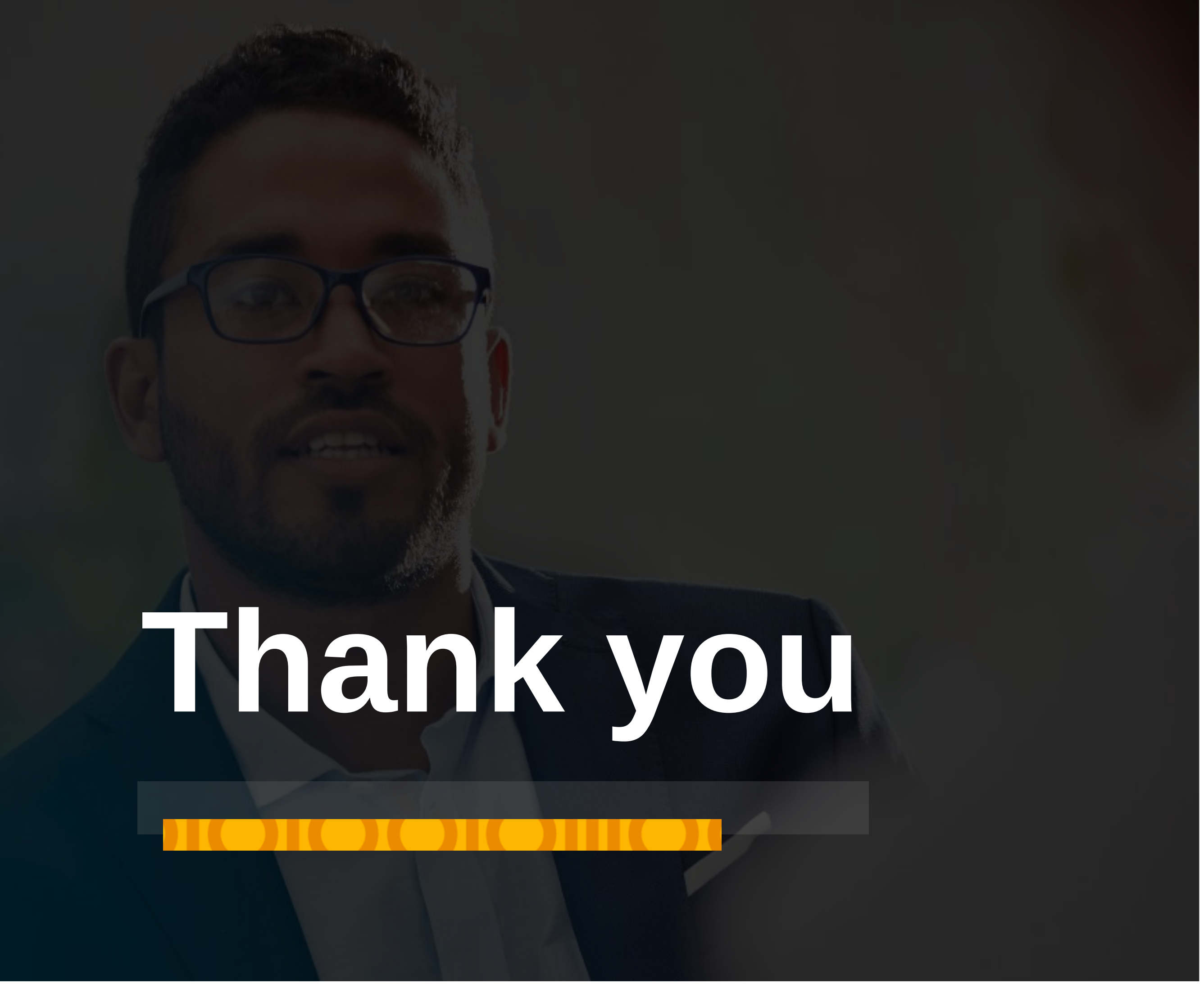
Creating continuous Learning & Development opportunities for staff

Tax professionals of the future will be highly proficient in data analytics, technology, process improvement and change management. Thus, the need to invest in upskilling members of the tax function. This helps in attracting and retaining the talent needed to deliver on Tax's goals and objectives.

Conclusion

The tax functions of organisation in FS Industry have experienced significant disruption and will continue to experience the disruption due to the increased tax compliance and regulatory reporting. Tax functions that insist on old or traditional ways of doing things risk losing both relevance and competitive edge. Our survey reveals that tax functions can use the disruption as an opportunity to examine ways to improve their performance and explore what is possible.

Finding what works for you requires thoughtful consideration of the tax strategy, target operating model, tools, processes, and skills that will be required to address your immediate priorities and get ready for what is ahead.



Thank you

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