Chapter 1

EXECUTIVE SUMMARY

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§ 1.04 Enablers and Deliverables
§ 1.05 Purpose of the Guide
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§1.01 INTRODUCTION

In the last few years the increase in globalisation and the application of new technologies has led to major changes in the way business is done. Over the same period there has been a transformation in the approach by the regulators, with many countries around the world implementing more rigorous corporate governance regimes. This changing business environment has had a dramatic impact on the management of taxation by businesses.

Not only have we seen increasing complexity in managing the cost of taxes, both locally and cross border, we have also seen significant challenges for reporting and compliance. The US Sarbanes-Oxley legislation is aimed at significantly improving the integrity of financial reporting; however this has exposed serious problems with the quality of tax reporting in many companies. Tax continues to be the most frequently cited areas of material weakness under section 404 of the Act and we have no reason to believe that the experience would be any different for tax accounting by non-SEC companies.

The business and regulatory environment of the last few years has thus increased the scrutiny on tax functions and caused a number of behavioural trends within tax functions—some positive, some not so positive. We have particularly witnessed the global pendulum swing towards a focus on risk management and compliance. In many cases this has resulted in companies becoming more conservative and risk averse at the expense of managing the tax costs for their organisation. The increased focus on tax and the tax function is gradually improving the transparency around taxation, the contribution to value and the management of risk.

§1.02 A VISION FOR TOMORROW'S TAX FUNCTION

We are often asked questions such as 'how should I structure my tax function?' or 'how many people should I have in my tax function?' The answers to these questions will depend on both the nature and global footprint of the business and what the business and the tax function is trying to achieve—the objectives for the tax function.

The tax function's objectives should themselves be driven by what is happening in the business and the wider business and regulatory environment. While the objectives of different tax functions will vary in the detail, we believe that the effectiveness of the tax function is fundamentally based on its ability to achieve three core objectives:

—Create, protect and optimise **value** in the context of the organisation's business objectives;
—Manage a wide range of tax related **risks** from carrying on business; and
—Ensure **compliance** with tax laws and reporting requirements.

Tax planning and advisory activities should be focussed on optimising tax outcomes and managing risk, both in respect of strategic transactions and day to day operations. Compliance and reporting activities tend to be process driven activities that are focussed on both risk management and external communication of tax outcomes. It is critical for the effectiveness of the tax function that an appropriate balance is reached between the achievements of the three core objectives set out above.

§ 1.03 A TAX MANAGEMENT FRAMEWORK

We have established a framework for how a tax function should operate. The starting point is the tax strategic plan. For this plan to be implemented there are a number of "enablers" which need to be put in place. The results of the plan, together with the enablers, are the various "deliverables" that are the outputs required for the successful management of the tax affairs of a business. To achieve the right balance, the tax function needs to understand and focus on the enablers as well as the deliverables.

§ 1.04 ENABLERS AND DELIVERABLES

The enablers are the tools, methodologies and skills that are required for the successful implementation of the tax strategy. We have defined eight key enablers which are:

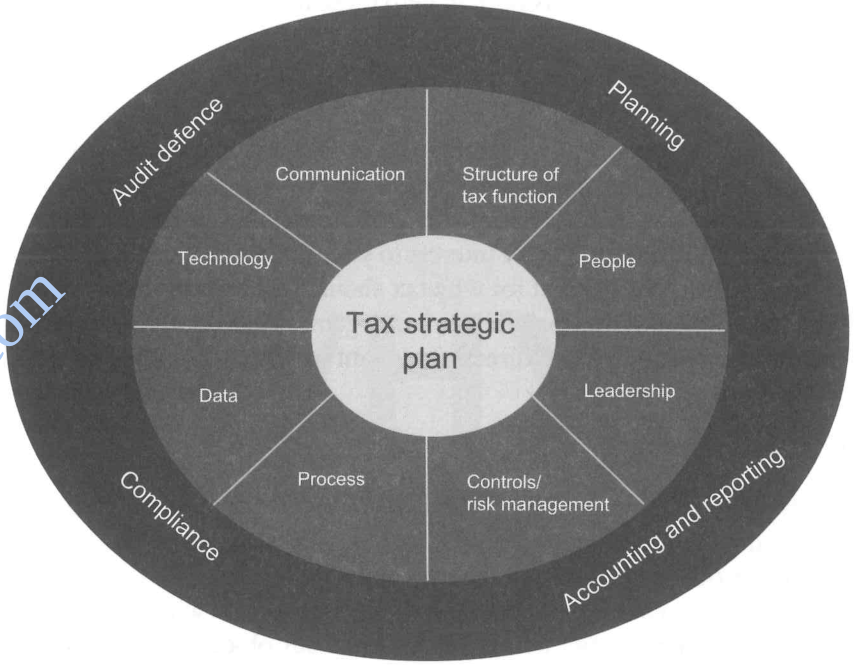
1. Structure of the tax function—how you best organise your people
2. People—establishing effective teams of people who, together with other internal/external resources, have the right mix of skills and experience.
3. Leadership—ensuring tax is aligned with corporate objectives and has an appropriate profile in the organisation.
4. Controls and risk management— integrating risk management processes and controls around the tax function's deliverables.
5. Process—optimising processes to improve efficiency and accuracy.
6. Data management—ensuring both quality data is available and proper data management is in place.
7. Technology—investing in effective systems to enable streamlining and automation of processes
8. Communication–impactful communication to manage relationships with internal and external stakeholders.

The deliverables represent the outputs of the tax function that must be accomplished each year, quarter, month and week in order for the tax function to meet its objectives. There are four key deliverables in respect of managing tax which are:

1. Tax planning
2. Tax accounting and reporting

3. Tax compliance
4. Audit defence

This framework for tax function effectiveness is set out in the 'enablers and deliverables' diagram below.



§ 1.05 PURPOSE OF THE GUIDE

The purpose of the guide is to set out the *Why*, *What*, and *How* of managing an effective tax function based around the above framework. Our starting point is to look at *Why* tax needs managing, putting some additional context around the key external business and regulatory drivers impacting on the management of tax. We then deal with *What* needs to be managed within an organisation in relation to tax, expanding on the concept of the enablers and deliverables and what we mean by tax risk. The *How* section sets out best practice tools, methodologies and approaches for creating a tax strategic plan, developing the enablers and executing the deliverables.

In addition to the enablers and deliverables there are a number of other competencies that are related to managing the effectiveness and sustainability of the tax function. These include performance measurement, benchmarking and managing change. Developing these competencies will enhance the enablers and ultimately the achievement of the tax function objectives. These areas are covered in separate chapters in the *How* section of this guide. The above diagram will act as a roadmap for various chapters in the *How* section, taking you through the enablers first, then the deliverables, followed by the other topics of interest.

In writing this guide we have drawn upon the experiences that we and our colleagues at PwC have had over a number of years in advising tax functions around the world. Our focus has been to help these tax functions be more effective.

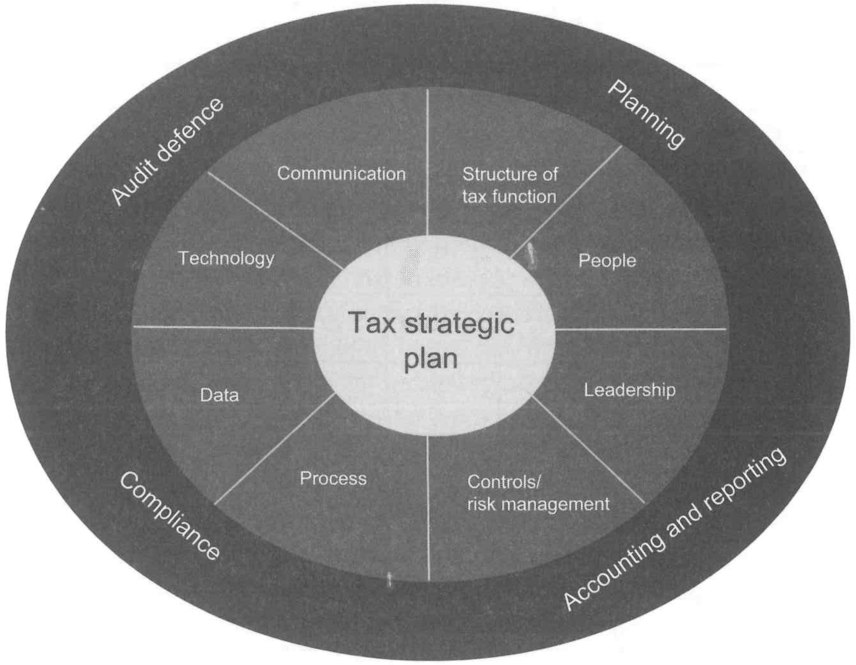
§ 1.06 USING THE GUIDE

The guide is aimed at a number of different audiences. Those directly involved in leading a tax function should be interested in all three sections. For executive directors, while the detail in the *How* section may be more than you need, the *Why* and the *What* should be of interest to you. For a non-executive director the *Why* section sets out the context for why tax should be on your boardroom agenda. For other stakeholders in the tax affairs of an organisation, you may want to dip into the various chapters which are directly relevant to your particular interests.

§ 1.07 SUMMARY

Different businesses will do things in different ways, have different corporate practices and indeed different corporate cultures. What we have tried to do in this guide is to set out some food for thought as to the hallmarks of an effective tax function. If we do no more than stimulate the debate around what is best practice in managing a tax function, we will have achieved our objectives.

WHY?


Audit defence
Planning
Communication
Structure of tax function
Technology
People
Tax strategic plan
Data
Leadership
Process
Controls/ risk management
Compliance
Accounting and reporting

Chapter 11
TAX RISK

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§ 11.07 Summary

§11.01 INTRODUCTION

As noted in chapter 9, one of the key enablers for the tax function is controls and tax risk management. In order to manage tax risks it is important to understand firstly what the tax risks are in your business. The purpose of this chapter is to provide an explanation of what we see as the main areas of tax risk and why they arise, so that we can start with a common understanding of what it is we are talking about when we move on to what controls are needed and how tax risk can best be managed.

§11.02 WHAT IS TAX RISK?

The decisions, activities and operations undertaken by an organisation give rise to various business risks. Some of these risks will be in respect of tax. These risks may be in relation to uncertainty regarding the application of tax law and practice to particular facts (including future changes to the law). It may be uncertainty over the facts themselves or the standard of documentary evidence to support the position taken. It may be uncertainty as to how well systems operate to arrive at the tax results of the business activities and operations. These uncertainties give rise to tax risk.

Tax risk can be defined as the risk of not meeting organisational or tax group objectives in relation to tax strategy. In its broadest sense, tax risk includes any consequence relating to the application of tax strategy and planning, day-to-day operations, compliance or external reporting that adversely impacts a business in the form of cash tax liability, financial statement errors or misstatement or reputational damage. Acknowledging that tax risk can relate to the risk of not meeting tax strategy objectives underlines the fact that risk can relate to failing to realise particular planned results or outcomes, sometimes referred to as "upside risk".

§11.03 OBJECTIVES OF TAX RISK MANAGEMENT

A key element of a company's tax policy is articulating how much risk the organisation is prepared to accept. We are often told that a particular business' tax risk management objectives are to minimise risk. Our core proposition is that managing risk is not about minimising risk, but is about optimising risk and value by determining what level of risk is acceptable to that business relative to value and then managing and monitoring the risk. It is about managing tax risk, not minimising it. Indeed in our dealings with some clients we have challenged them as to whether they are taking enough risk. Businesses make profits by taking risks and a no-risk strategy is probably neither cost effective nor right for any business.

Like other business risks, there is a clear trade off between tax risk and value created (or defended) by the tax function. In managing tax risk, an organisation therefore needs to find the appropriate balance between the risk taken and value (or return) achieved based on the agreed risk profile of the group—and we will consider this in more detail in chapter 13.

We should make it clear that we believe each business has a responsibility and duty to pay the appropriate taxes in respect of its business operations. We also consider it critical that organisations manage and plan their tax affairs to optimise after tax outcomes within the parameters provided by the laws in the countries that they do business. However, we work on the assumption of full and proper disclosure and accordingly, none of the following has regard to what some might term detection risk.

§ 11.04 TYPES OF TAX RISK

In our view there are four specific categories of risk associated with taxes. These are:

1. Strategic and transactional risk;
2. Operational risk;
3. Compliance risk; and
4. Financial accounting risk.

However there is further category of risk that could arise in conjunction with any of the specific categories above. This is reputational risk which is a potential impact or consequence that is initially non-financial, but which can have a major impact on the tax affairs of an organisation. Given its importance to tax management, we will treat it as a separate category. The specific areas of tax risk are explained in more detail below.

§ 11.05 SPECIFIC RISK AREAS

[A] Strategic and Transactional Risk

This type of risk concerns the exposures associated with strategic planning and major or non-routine transactions undertaken by a company. In any strategic transaction there may be uncertainty as to how the relevant tax law will apply to the factual circumstances and positions will need to be taken that require judgement. For complex transactions, there may be a number of interrelated tax uncertainties potentially across different jurisdictions and taxes.

The more unusual and less routine a particular transaction is, then generally the greater the likely tax risks. One-off, non-routine transactions, such as acquisitions/disposals of businesses or parts of a business, or significant restructuring projects and reorganisations will generally bear greater tax risks than the routine every day business such as selling products and services. In addition there are likely to be well-designed procedures and systems in place for the processing of routine transactions, which would usually not apply to non-routine, one-off transactions.

In terms of strategic and transactional tax risks, more important than minimising the risk is ensuring that the risk assumed is commensurate with the value of the business outcome for the organisation. We have seen many cases where the

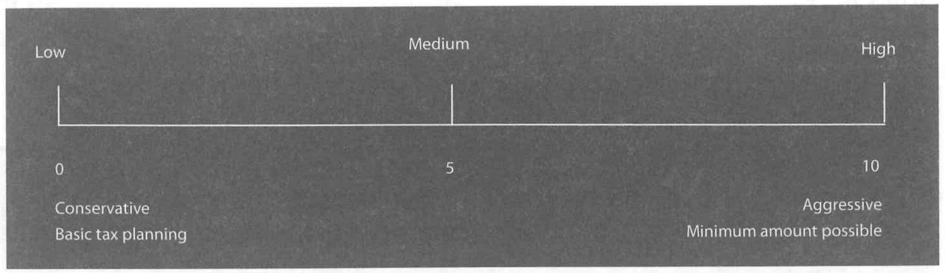
incremental benefit of pursuing a particular strategy is debatable when compared to the incremental tax risk.

Additionally tax risks can arise from failures, such as:

- The tax department is not involved in the transaction or is brought in only at the last minute;
- There is no organisational agreed framework against which to judge acceptable risk; and/or
- There is a failure to properly document, implement or maintain a transaction.

In our view this last point often carries the greatest risk for strategic transactions. Failure to implement, properly document or maintain what has been planned and agreed upon is, in our experience, the cause of a significant amount of tax risk for companies. The tax treatment may depend on a particular sequence of events, board meeting or wording in documentation and there is often a significant risk that the standard of documentary evidence will not adequately support the tax positions being taken in the event of being challenged.

The question then arises as to how much tax risk are you prepared to take in particular transactions and how much risk are you actually taking over the correct implementation of the transactions? What is your profile in relation to transactional risk?



It is important in considering this scale to indicate where you want to end up as distinct from the inherent risk in the transaction or tax planning strategy. Risks identified can in many cases be managed, such that a risk initially identified as being at an unacceptable level may be capable of being brought down by a tax ruling or some other approach. This recognises that risks can be managed so that the potential upside benefit is not lost.

[B] Operational Risk

Operational risk concerns the underlying risks of applying the tax laws, regulations and decisions to the routine every day business operations of a company.

Different types of operation will have different levels of tax risk associated with them. For example, compare normal third party product sales with intra-group cross-border products sales; there are greater tax risks associated with connected party cross-border transactions (primarily transfer pricing issues). This is one example of tax risks that can occur from the normal ongoing business of a company.

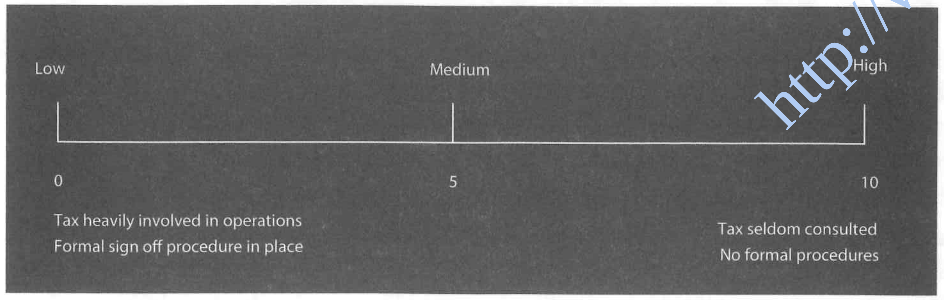
Another example that can arise is associated with the increasing globalisation of trade. This can result in an ever increasing risk of operational people inadvertently creating a taxable presence or permanent establishment (PE) in another country. An inadvertent PE can arise from an array of situations such as:

- Companies who contract employees to work on overseas assignments;
- Agents of companies working in other jurisdictions who enter into agreements on behalf of the local company;
- Setting up a representative office in a foreign country;
- Companies looking to expand services overseas; and
- Companies who work on a project basis where employees can be relocated for an extended period of time.

The tax consequences of having a PE can extend to a number of different taxes and obligations including direct tax, VAT, employment taxes and transaction taxes such as stamp duty and can represent an absolute cost to the business.

In our experience the closer the tax function is to the business operations the better these types of risks are managed. Communication between the various parties is key.

Where are you today on the operational risk scale—and where would you like to be?


Low
Medium
High
0
5
10
Tax heavily involved in operations
Formal sign off procedure in place
Tax seldom consulted
No formal procedures

[C] Compliance Risk

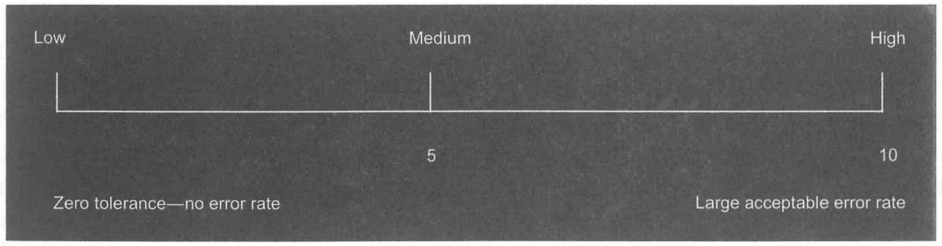
Compliance risk concerns the risks associated with meeting an organisation's tax compliance obligations. As we noted earlier, we do not believe risk of discovery by tax authorities is a factor. One must assume full disclosure and that the authorities are aware of and will review your activities. From a tax perspective compliance risk would primarily relate to the preparation, completion and review of an organisation's tax returns (of both corporate tax and other types of tax returns) and the risks within those processes.

Compliance risk addresses the risks implicit in the systems, processes and procedures adopted by a company to prepare and submit its tax returns and in responding to any enquiries/issues raised in the process of reaching an agreed position with the authorities.

What we are talking about here is:

- The integrity of the underlying accounting systems and information;
- The effectiveness of processes to extract tax sensitive information from the accounting system;
- Ensuring the tax compliance analysis processes are based on up to date knowledge of the latest tax law and practice; and
- The proper and efficient use of technology in the processes.

There are clearly cost implications in where you position yourself on the scale below and there will be a trade off between costs spent and risks taken. To achieve no errors in any tax return will undoubtedly be cost prohibitive. Alternatively, are you over engineering the process and could you reduce the cost with little or no impact on your risk position? What is your attitude to tax penalties? Where do you want to be on the scale below—and what changes need to happen in the way you operate to get you there?

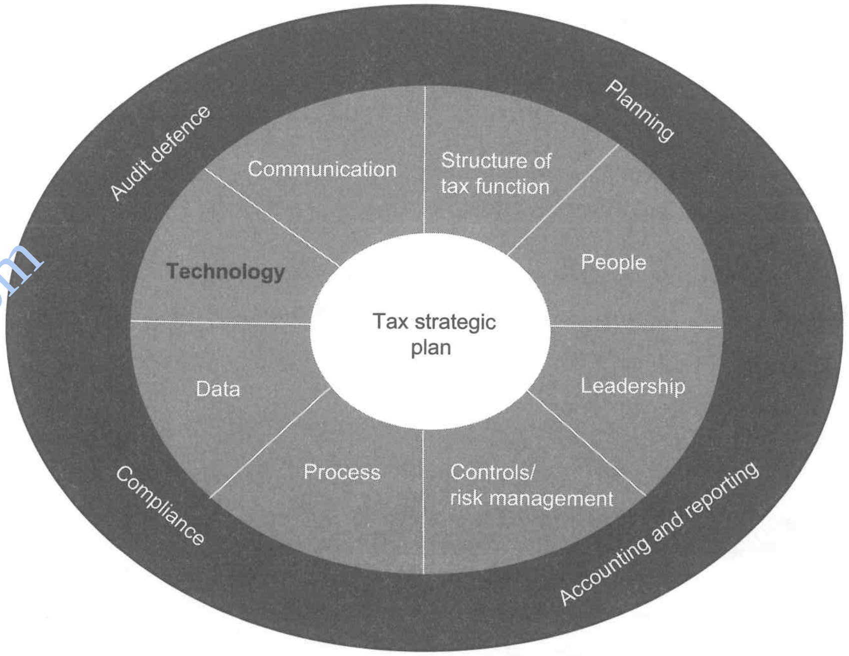


Tax compliance risk also includes the risks arising from agreement of tax returns and from enquiries on, or the audit of, submitted tax returns by fiscal authorities. In a number of countries the final agreement of a tax return often ends in a 'horse trade' between the taxpayer and the relevant revenue authority; one might even argue that it may make sense to have a number of aggressive positions in the return so that there is something to give as part of any negotiations.

Additionally, with how many of the group's tax returns is the tax function actively involved? What about payroll tax returns, indirect tax returns, and customs

Chapter 20

USING TECHNOLOGY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Controls/ risk management
Compliance
Accounting and reporting

§ 20.01 Introduction

§ 20.02 What Do We Mean by Technology?

§ 20.03 The Component Parts
- [A] Financial System Integration
- [B] Data Warehouse (DW)
- [C] Data Collection
- [D] Web Portal
- [E] Third Party Applications
- [F] Document Management Systems
- [G] Web Access

§ 20.04 Leveraging Existing Finance Function IT Systems

§ 20.05 Tax IT Personnel

§ 20.06 Benefits of Technology
§ 20.07 Tax Technology as a Journey
§ 20.08 Summary

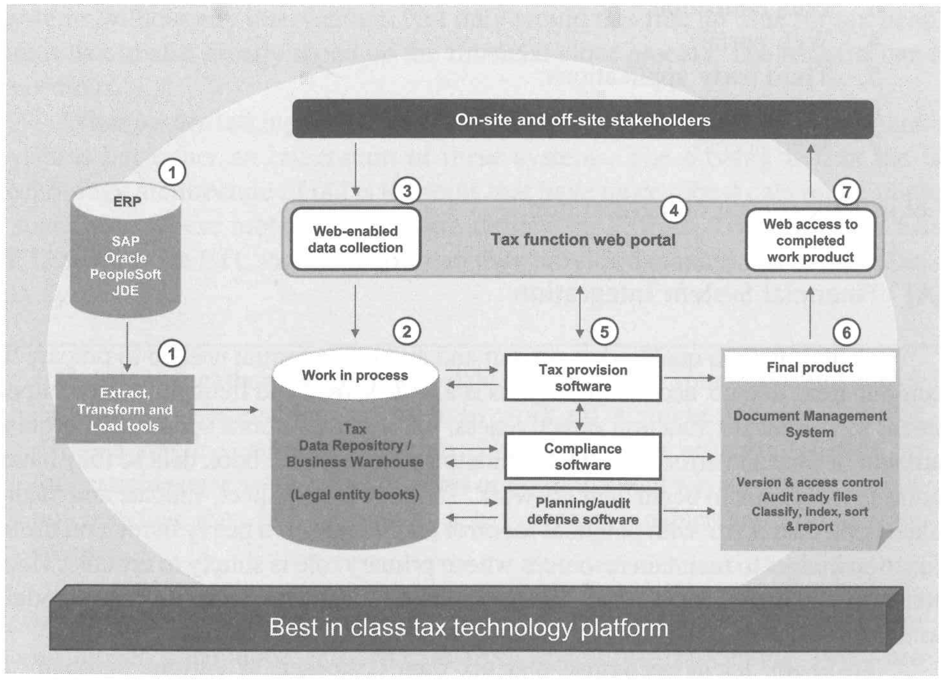
§ 20.01 INTRODUCTION

Having world class people to lead and work within the team is critical to the overall effectiveness of a best in class tax function. However on par with the people is technology. 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.

Let us begin by explaining what we mean by tax technology—what its components are, its functionality and how these various components work together to deliver efficiencies, improve quality and manage risk. Once we have defined tax technology we can then explore the value you should expect to derive from deploying some or all of these components.

§ 20.02 WHAT DO WE MEAN BY TECHNOLOGY?

We have developed an example of a best in class tax technology platform. This is illustrated in the diagram below and developed further in the coming pages.


On-site and off-site stakeholders
1
ERP
SAP
Oracle
PeopleSoft
JDE
1
Extract, Transform and Load tools
3
Web-enabled data collection
4
Tax function web portal
7
Web access to completed work product
2
Work in process
Tax Data Repository / Business Warehouse
(Legal entity books)
5
Tax provision software
Compliance software
Planning/audit defense software
6
Final product
Document Management System
Version & access control
Audit ready files
Classify, index, sort & report
Best in class tax technology platform

We recognise the term 'best in class' is a vague notion and no single definition of what is 'best' is widely accepted. Moreover, the accepted version of what is best varies considerably from one organisation to the next. With that said, we have based the above model on:

1. Our visits with many of the Global Fortune 1000 companies and observing, first hand, how these leading tax organisations address their technology requirements,
2. Developing our point of view during the course of our many client engagements where we have collaborated with senior tax executives, and their finance and IT leaders, and
3. Our discussions with senior executives from the leading tax technology vendors.

§ 20.03 THE COMPONENT PARTS

You will notice within the diagram the numbers 1 through to 7 which are intended to highlight the distinct components of the technology platform. We will make reference 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.

Let us look at each of these in turn.

[A] Financial System Integration

Acquiring high quality data on demand and in the format needed to prepare tax computations and tax accounting figures is a wide spread and frequently cited impediment to overall tax function effectiveness. Most tax functions spend an inordinate amount of time and effort to collect, validate and manipulate book data so they have a good starting point to begin their tax work. The process to collect, validate and manipulate book data is rife with potential for error and represents a heavy burden on the tax function budget to maintain resources whose primary role is simply to ensure a viable starting point for tax calculations. The key here is better use of technology substantially to minimise the effort required to collect, validate and manipulate data.

To begin, let us recognise that tax data is housed in various company IT systems that may include:

- ERP systems
- Financial consolidation systems

- Payroll systems
- Fixed asset systems
- Inventory systems
- Other industry specific feeder systems (e.g. brokerage systems, R&D systems.)

The traditional approach positions tax as wholly dependent on those who have direct access to the systems or 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 in what is typically a very inefficient process, resulting in delays while waiting for a reply, and then both validating the report once received and manipulating the data (typically in a spreadsheet) so it is in a useable format to support a tax computation or help produce tax figures for the accounts.

Consider how much better it would be if tax professionals used technology to the fullest extent possible to automate the data collection by reaching directly into the various and numerous source systems, then standardising that data within a ‘staging area’ and finally, pushing the standardised data set to tax specific systems such as tax accounting software, compliance systems and analytical tools. Much less effort would be necessary to validate data that is sourced directly from finance systems without any intervention. Not only would this free up time for tax people but it would also greatly speed up the financial close process. The benefits can be enormous.

What we are talking about 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 is the tools that have more robust data manipulation capabilities. These tools as a class are defined as Extract, Transform and Load (ETL). What are ETL tools and how can they provide a major boost to the value of tax systems?

> 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 no longer spins 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) are no longer ‘nice to have’, but essential to success. These systems are no longer 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.

ETL tools have the ability to speak with virtually any other software application to extract and standardise relevant data, and push it to another software application of your choosing. That has the potential to overcome the complexity, inefficiency and risks of collecting the numerous elements of book data from 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. We therefore suggest you begin your quest to understand how ETL and business intelligence systems can support your tax function by learning how your company is already using these tools in support of other areas within finance. There are also a number of ETL vendors in the market who would be more than delighted to help you in this area.

[B] Data Warehouse (DW)

The second technology component is the data warehouse. The terms data warehouse and data mart are often used interchangeably and while there are certain technical differences between the two, for purposes of this discussion, we will combine the two. We use the term data warehouse to mean:

> 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 simpler and more efficient to run queries over data that originally came from different sources.

The benefits that a data warehouse 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 major leap forward for most tax functions but what else can be achieved within the DW environment that can further enable tax effectiveness?

You should view the tax DW 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 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 3rd party applications to facilitate analysis, audits, planning or forecasting. You should consider developing standard reporting from the DW to serve as your standard set of tax work papers supporting the tax accounting and compliance processes.

Building tax DW functionality can be an expensive proposition. The single most viable alternative is to look within your finance function for either an existing DW or a data warehouse 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.

We are often asked about the need and benefits for a DW for a given company. The general answer is that the more disparate the sources of data, the more 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 that a single domestic business with one integrated ERP. These benefits will especially arise for acquisition-oriented companies that tend to allow their targets to maintain historical ERP applications rather than quickly integrating their systems.

[C] 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 a best practice as it is difficult to ensure 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 formulas. These common practices make it very difficult to extract data from spreadsheets efficiently since 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 email 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 via 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.