

# The 'best practice' tax function

Second edition



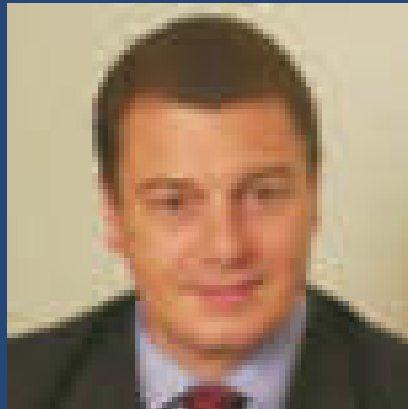
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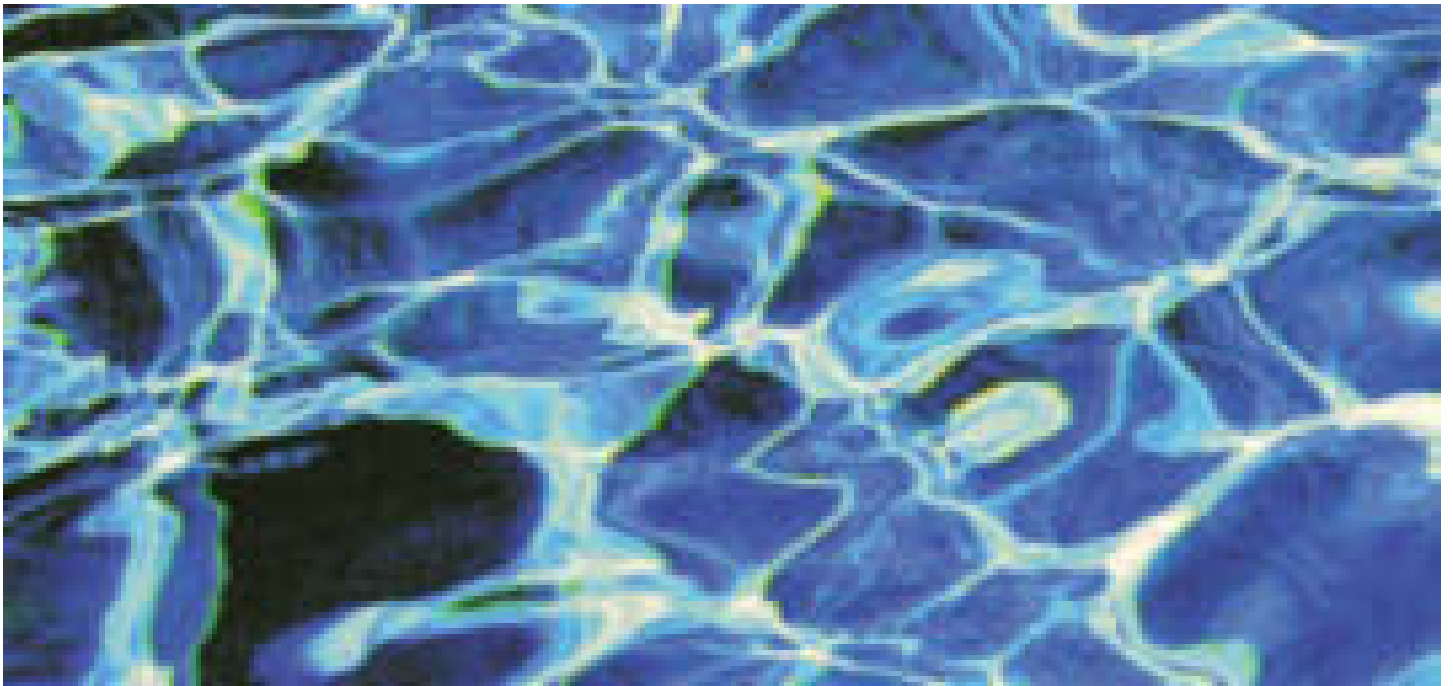
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## Preface to second edition

The first edition of this guide was published in May 2002. Since then there has been various reprints of the first edition and over 8,000 copies have been distributed on a worldwide basis.

Most of the principles and ideas set out four years ago have stood the test of time and the ongoing demand for this guide suggests that these ideas are as relevant today as they were then.

However the world has moved on, not least in the area of corporate governance. One of the objectives of the first edition was to encourage businesses to ensure they had a properly documented tax strategy which had been discussed and agreed at board level. We now believe that such a document is a must, rather than a nice to have (not least due to increased investor interest in tax strategy). We are often asked to write, or help write, tax strategies for businesses. We believe that a strategy needs to be something that has been produced and bought into by the in-house team, rather than being written by an external advisor. Having said that we recognise that organisations often need some support and challenge in producing their tax strategy document. We have therefore included, in *Appendix III* to this second edition, a framework that we often use to help our clients produce a tax strategy document.

Another area which has moved on considerably over the last four years is tax risk management. Rather than re-write the section in this guide we would now refer you to our separate *Tax Risk Management guide*, which was published in 2004. On the back of this guide we are working with a number of organisations helping them to produce their tax risk management frameworks and their tax risk policies. This is undoubtedly an area that will continue to evolve as people develop more practical experience.

Since publishing the last edition, there has also been an increasing focus on the issue of corporate and social responsibility. Many businesses are seeking to get a better handle on the total tax contribution that they make to the exchequers of different countries around the world. Corporate income taxes are perhaps the headline figures that can be readily ascertained from published sets of accounts. However, the total tax contribution which businesses make also include irrecoverable VAT and sales taxes, payroll taxes, real estate taxes, capital taxes, environmental taxes, state and local taxes, and withholding taxes as well as customs and excise duties. In

addition to the public relations benefits of being able to explain the total taxes being paid by the organisation, having this information allows a more focussed tax strategy and a more focussed approach to tax risk management. We have therefore included, in this second edition, a couple of paragraphs on determining your total tax contribution; this is included at the end of *section 5*.

Finally, tax reporting and communication is another area that is receiving increasing focus. Whilst we have not made any changes in this area in this second edition, we are planning a separate guide on tax communication and reporting.

Subject to the changes noted above, this second edition is essentially the same as the first edition of four years ago. We hope and trust that we can continue to stimulate the debate around the role of the tax function in a business and help to bring focus and clarify as to what the function should be seeking to do in it's day to day activities.



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July 2006



# 01 Introduction

## What is best practice for an in-house tax function?

In our work with in-house tax functions we are often asked “What does a ‘best practice’ tax function look like?” Whilst there is no one right answer, the purpose of this booklet is to encourage tax directors in commerce and industry to challenge themselves and their teams with some fundamental, searching questions. These questions include:

- why are we doing what we are doing?
- should we be doing different things? or
- should we be doing the same things but perhaps in different ways?

The booklet is also aimed at finance directors (or other people to whom tax directors report) who should be asking the questions “What am I looking for from our in-house tax function?” and “Am I getting best value for the money being spent?”

This booklet follows on from the research carried out by Dr Brenda Porter (then of Cranfield School of Management) on behalf of PricewaterhouseCoopers over the past few years. The results of Dr Porter’s research have been summarised in our *Tax function 2000*

and *Tax function 2001* reports. However most of what follows is based on discussions with in-house heads of tax about the real tax management issues they face. Much of this experience is in respect of UK headquartered businesses, but our work elsewhere and the experiences related by our overseas colleagues suggest that much the same themes apply in other territories too. We are also grateful for the input of Peter Davies who has been there and done it – Peter was head of tax at Unigate in the 1980s and National Power in the 1990s.

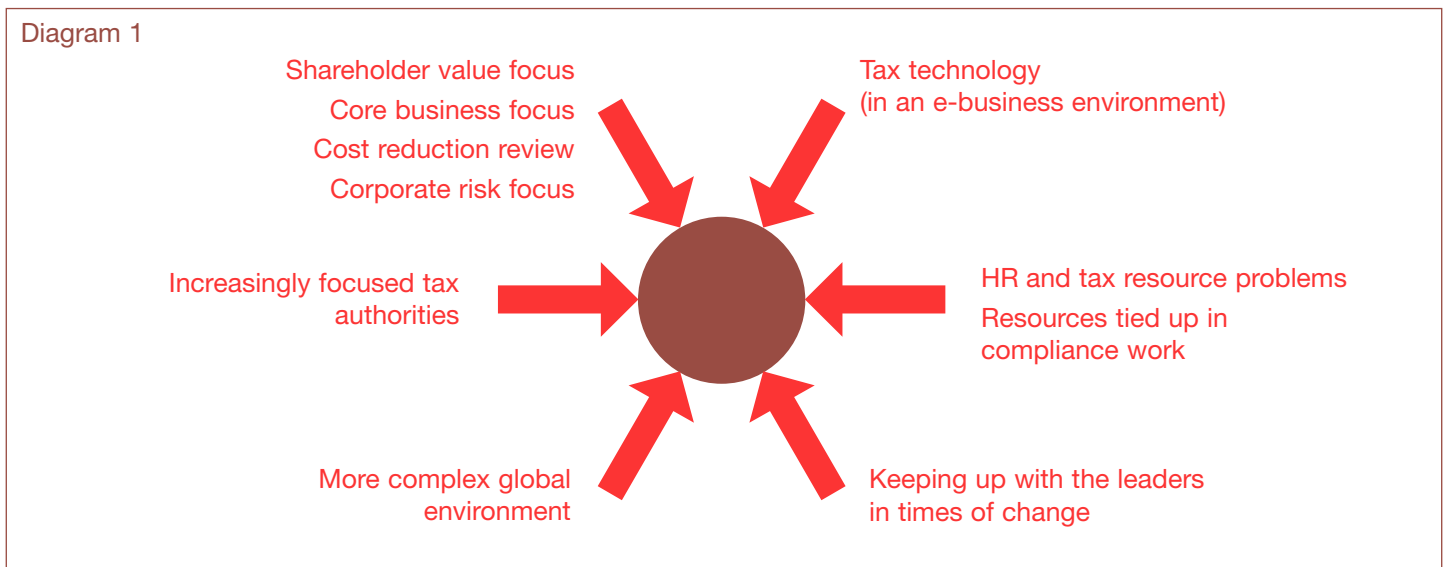
This is not a manual on how to run a tax function. Different circumstances demand different solutions (and hence benchmarking data tends to be of limited help in evaluating tax functions). What we have tried to do is provide ‘food for thought’ to stimulate discussion and to serve as an aide-memoire of issues to cover when a company addresses its approach to tax management. By highlighting these issues we hope we can encourage tax directors to take a fresh look at their approach to tax management and how they run their tax departments. As well as throwing down these challenges, we have also sought to provide some ideas and tools to meet these challenges.



# Change drivers for the tax function

“If you’re not riding the wave of change, you’ll soon find yourself beneath it.”

In our experience, taking time out to sit back and rethink the group’s approach to tax management is not something that many heads of tax have managed to get to the top of their to-do list. However we believe they should. There are many changing pressures on the tax function, some internal and some external, which should prompt most businesses to review regularly their approach to tax management. *Diagram 1* illustrates some of these pressures.



These pressures, or change drivers as illustrated in *Diagram 1*, described to us by heads of tax, are spelt out in more detail below.

## At the corporate level

- An increasing focus on activities that add to shareholder value, with tax functions therefore being challenged to show that they are adding value to the business, not just sending the majority of their time on basic compliance.
- An increasing focus of a company’s resources on core business activities, with ‘back office’ activities, such as tax, not being seen as areas for investment.
- Greater focus by companies and Boards on risk management, where tax is often recognised as a key corporate risk.
- Globalisation producing larger, more complex, more diverse ‘empires’ for the tax function to manage.
- The current climate of rapid corporate change meaning that companies need to ensure they can be flexible in their approach to tax management and resourcing. The increasing rate of change in the size, structure and approach of businesses will require tax functions that are designed to cope with such change.
- Cost reduction pressures requiring process efficiencies from tax functions and their service providers.

## The fiscal climate

- A growing conflict between a global approach to management and a local, jurisdictionally based tax environment.
- Increasingly focused and co-ordinated tax authorities.
- Increasingly complex tax legislation becoming more time consuming to understand and comply with, as well as presenting greater tax risks.
- In many countries, the economic downturn damaging government revenues, in turn leading to greater effort from the tax authorities to identify additional tax revenues.
- In the UK, an increasing compliance burden brought about by corporate tax self assessment, combined with a greater Inland Revenue focus on larger corporate.
- New tax authority working methods, in particular in the IT field, enabling them to look at levels of detail not previously practicable.

## HR and tax resource issues

- Difficulty in recruiting and retaining quality tax staff (particularly for compliance work).
- The need to keep a tax team dynamic and fresh, whilst at the same time maintaining continuity and business knowledge.
- Difficulty in offering career progression for tax staff in all but the largest tax functions.
- The increasing drain on tax function time of staff performance, appraisal and development work.

## Tax technology

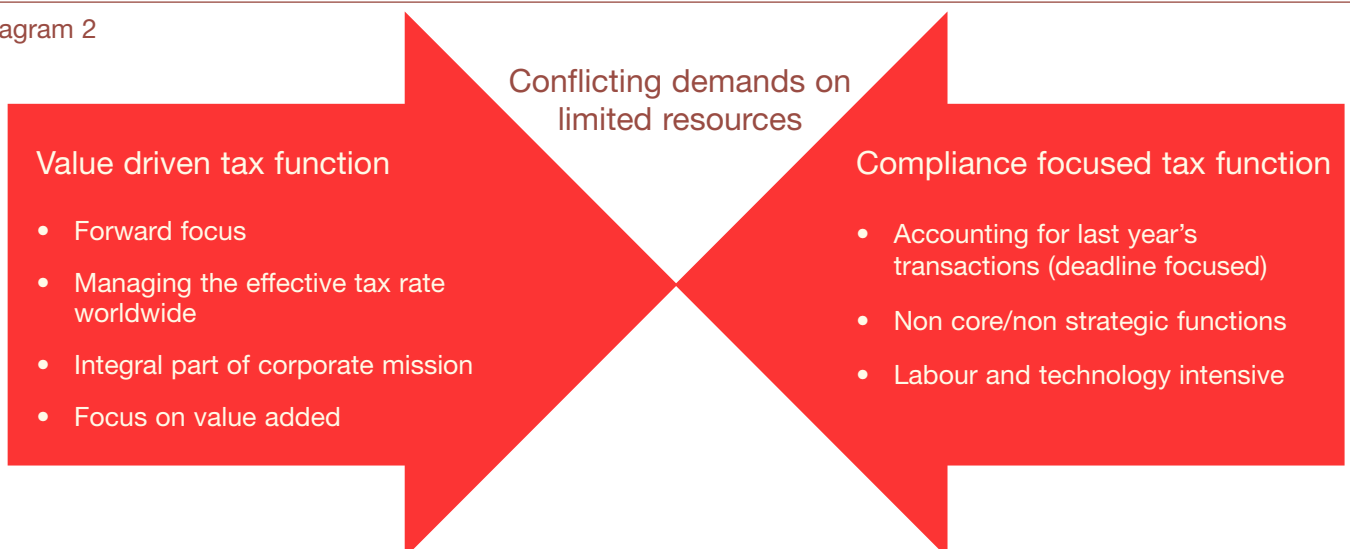
- Advances in tax technology offer efficiency and performance improvement, but the increasing complexity of such technology makes it more costly and risky to maintain in-house. This is only likely to increase.
- Companies are reluctant to make IT investments in non-core activities.

## Summary

To summarise, there is a recognition that, in the face of increasing change, tax functions are going to have to become increasingly adaptive in order to keep up with demand and with best practice. Tax functions are also typically under pressure to achieve this whilst at the same time having their resources squeezed.

It is not that tax functions are failing to evolve. We have observed a clear trend away from the tax function being 'back office storekeepers' and 'technical boffin' to being 'at the business end' of an organisation, having much more influence on corporate activity than historically was the case (moving towards the left of *Diagram 2* below). Neither are we suggesting that most tax functions are in some sort of 'burning platform' situation (though we do see some that are). Rather we suggest that in the face of the pressures listed above, heads of tax should be looking closely at their tax function's roles, strategy and operational practices. We hope that the following material will help with this.

Diagram 2





“... in the face of increasing change, tax functions are going to have to become increasingly adaptive in order to keep up with demand and with best practice.”

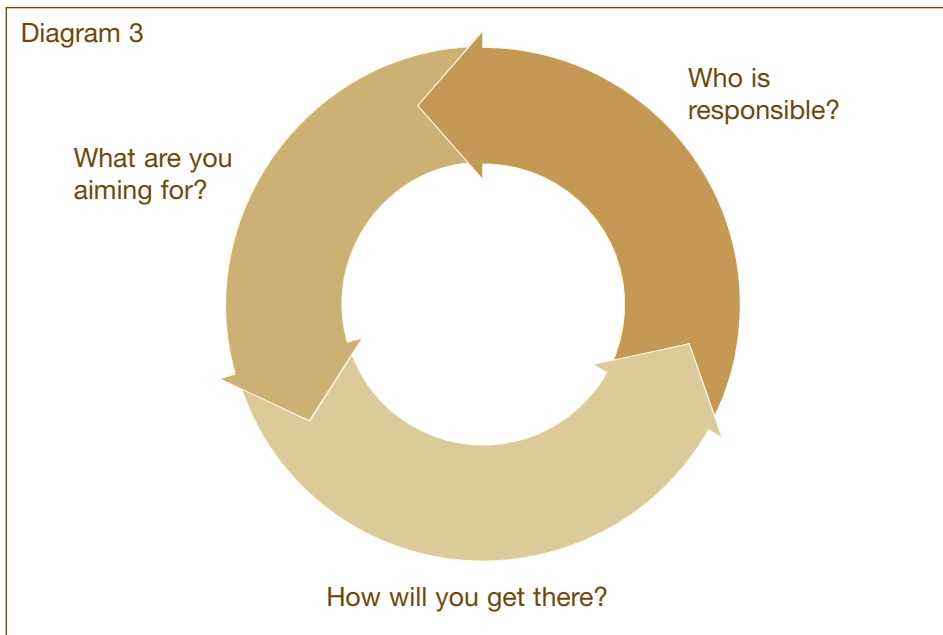


# 03

## The tax strategy – and what should be included

### What do we mean by ‘tax strategy’?

*An outline of what the tax function has to achieve and the plan for getting there, starting from the current position (see Diagram 3).*



### Why set out a tax strategy?

Most tax functions we know have objectives and task lists, but not many have set down what we would call a proper tax strategy. Operating without a strategy has been compared to making a long road journey using only the speedometer and the fuel gauge for information, but without a map, traffic information or road signs. The speedometer might show that you are continuing to make good progress, but will you end up where you need to be?

When we are working with tax functions who are ‘taking stock’, clients often ask “How many staff should a tax function have in a business this size?” or “What should my budget really be?” They are often

frustrated when we suggest we cannot give such an answer until the tax function is clear as to its role and strategy. It is pointless trying to dictate resource until it is clear what the resource is needed for. We suggest that the tax strategy is the starting point for setting objectives and priorities, and then for negotiating for and allocating resources accordingly.

You may have noticed that rather than suggest that tax functions do not have strategies, we referred to ‘not having set down’ or ‘not being clear as to’ tax strategy. Most tax directors do of course have some form of tax strategy in their minds (though, by their own admission this is often not effectively communicated to senior management). However our practical experience is that setting down the tax strategy on paper is normally a very useful process to go through. Here are some of the benefits we have seen.

- The strategy can provide the framework/protocols by which the tax function operates.
- Senior management can confirm that the tax strategy aligns with the business strategy (and indeed identify whether the business strategy should incorporate some tax issues).
- It can also serve as a useful communication tool with the executive, the tax function, business staff and external advisers. (*More on communication in Section 9.*)
- Circulating a tax strategy helps raise the profile of tax issues and pushes tax higher up senior management’s agenda.
- When the strategy is set out on paper, it is easier to spot gaps or additional opportunities.

- The strategy document becomes a useful tool against which to check progress.
- Re-visiting the strategy on a regular basis (annually?) becomes an easier discipline.

## Who uses (or indeed contributes to) the strategy?

There are a number of different parties who have an interest in a written tax strategy. These include:

- the head of tax who needs a map as to where he/she is taking the tax team. The head of tax will also be the key player in designing the strategy;
- the CFO to whom most heads of tax report. The CFO will usually have high level input into the strategy design and use it as a framework in making tax related decisions and in monitoring how the tax department is performing;
- the rest of the tax team, including the overseas tax function and business/divisional tax staff, to ensure there is a common understanding of purpose and also for motivational reasons;
- the Board with whom agreeing the key points of the strategy can be a very useful exercise. Sometimes they prove to have a different view from the tax function and the process of discussing tax strategy with them has, in our experience, often added senior backing to the tax function's approach. Whatever the view of the Board, getting the tax strategy debated in front of them is good for the profile of the tax function;

- external advisers, where it can help them deliver more appropriate advice and filter out unsuitable ideas. They may also have a lot to contribute, particularly where they have helped other businesses with their tax strategies;
- operational people – who are responsible for decisions with potentially significant tax implications;
- the auditors, in order to give them comfort as to the likely level of tax risk and help them plan their work accordingly;
- other departments including legal, treasury, risk management and internal audit and even finance function staff responsible for provision of tax sensitive information; and
- the tax authorities? We are aware of some businesses that have shared their tax strategy with tax authorities in order to help demonstrate 'lower risks' than might otherwise have been perceived, although this is not a common approach.

## The overall approach

When we ask companies about their tax strategy, the initial answer is often along the lines of "Isn't it obvious? It's to minimise the tax charge and ensure we comply with the law". There are not too many businesses which would take issue with such a statement. However when we probe deeper, it is surprising the variation in approach we find. To stimulate the discussion about the 'real' tax strategy, we often use *the tax strategy template* (see *Diagram 4*).

This is an overview tool. It is not meant to be a scientifically perfect model of a tax function's strategy. It is a tool that helps clarify opinions as to overall approach and start discussions that draws out some of the underlying issues.

The three scales on the template represent the three areas we believe a tax function can control.

- The tax charge itself (and what is meant by tax charge is addressed later).
- Tax risk.
- The cost of running the tax function.

Diagram 4 – The tax strategy template

	<Reactive	Proactive>								
Tax charge	Not managed	Minimum legally achievable								
	0 1 2 3 4 5 6 7 8 9 10									
Tax risk	Basic tax planning	Aggressive schemes								
	0 1 2 3 4 5 6 7 8 9 10									
	Unaware of issues	Maximum awareness of issues								
Tax management costs	Minimum	Cost not the main issue								
	0 1 2 3 4 5 6 7 8 9 10									

The scales run from nought to ten. Nought represents a very reactive approach to tax management; probably little more than completing and submitting tax returns. Ten represents a very proactive (aggressive?) approach, where the head of tax would be prepared to spend time fighting a case in the senior law courts. We believe that, broadly, the three scales are correlated. One cannot have a very aggressive approach to managing the tax charge without incurring some legitimate tax risk and without incurring some extra costs. (There is a slight complication in that there is effectively an 'ignorance of the issues' risk scale, which runs in the other direction.)

To get an overall view of someone's approach to their tax strategy, and because of the correlation noted above, we ask them to draw a vertical line down the template giving a single overall 'score' between nought and ten. The more conservative and reactive groups would have a lower score than those who manage their tax more aggressively and proactively (see *Diagram 5*).

Diagram 5

	<Reactive	Proactive>
Tax charge	Not managed	Minimum legally achievable
	0 1 2 3 4 5 6 7 8 9 10	
Tax risk	Basic tax planning	Aggressive schemes
	0 1 2 3 4 5 6 7 8 9 10	
	Unaware of issues	Maximum awareness of issues
Tax management costs	Minimum	Cost not the main issue
	0 1 2 3 4 5 6 7 8 9 10	

In theory, to reflect efficiency, the line could slope from bottom left to top right, but for the purposes of understanding overall attitude to tax management, a vertical line is the clearest way of indicating one's viewpoint.

The template is a very simple way of clarifying where on the 'proactivity scale' somebody sits. However where it really does come into its own is when it is used to compare the views of different individuals working together in the same business.

Some real life examples we have seen when using the template include:

- a tax function that told us they had a good shared understanding of tax strategy, but then when each member of the team individually completed the template, their 'scores' ranged from two to nine;
- a company that completed the template whilst recruiting a new head of tax, and then tore up their draft recruitment advertisement as they realised that their desired strategy suggested they needed a very different individual from

the one that the draft advertisement suggested;

- a group whose Board identified that the tax function's robust approach was fine in current circumstances, but going forward would need to become less aggressive as the group needed steady results due to a forthcoming flotation; and
- a number of groups where the Board fed back that the tax function should be further to the right of the scale. (We often find that the tax function is more risk averse than the Board would like them to be.)

In helping clients formulate a strategy, we often start by getting them to identify where on the scale they are at present and then where they would like to be in two/three/five years time. This gives an idea of the scale of change that the strategy needs to bring about.





More than one tax strategy we have seen has included policies such as “We will not undertake any tax planning transaction which would reflect adversely on the group if details of it were to be published in the business pages of [Daily Newspaper Title].”



## What areas should a tax strategy address?

This will of course vary very much from business to business, but typical areas that could be addressed in a tax strategy are illustrated in *Diagram 6*.

However, as we will discuss later, a tax department will have to decide which of these sometimes competing factors are its top priorities – and thus put some focus into where its resources are best used.

For the document to be a true strategy (rather than just a list of high level objectives), it should also:

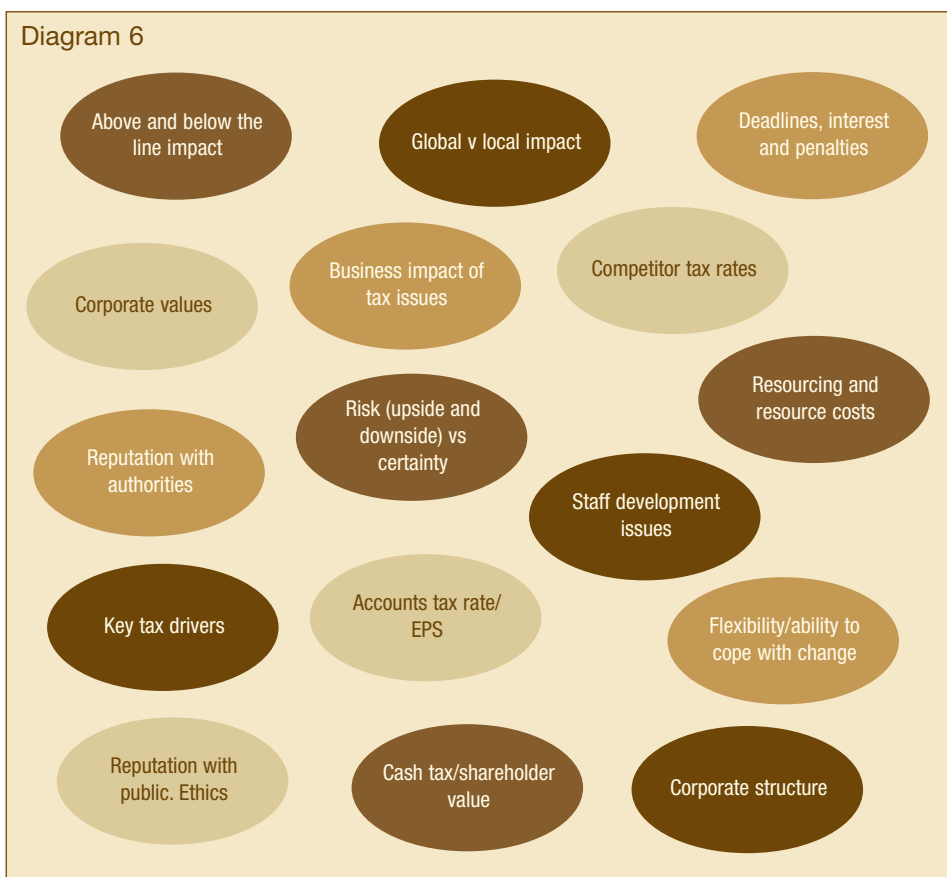
- set out the goals;
- outline the route-map for achieving them;
- be clear as to the timeframe; and
- set out responsibilities.

We include a sample template for a tax strategy template document at *Appendix III*.

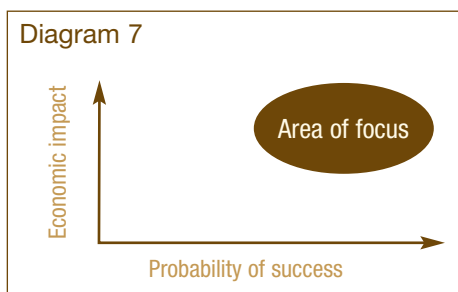
## Focus

A tax strategy covering all the factors set out in *Diagram 6* (plus related tactics and objectives) might be a very impressive document and would certainly demonstrate the huge potential workload facing the tax function. However there are not too many tax functions that have the time or ability to implement successfully a strategy covering all these points. As with most management challenges, the best chances of success will be where the tax team focus their resources on a limited number of key issues where there is the potential to make a significant impact without major investment or unduly complex projects.

Diagram 6



Whilst we have not seen it used by that many tax departments we believe ‘value driver analysis’ may be useful here. If the full list of goals/actions, probably drawn from the factors in the diagram, is plotted on a graph according to both the



expected economic impact and the probability of achieving success (as shown in *Diagram 7*), logic will probably suggest that the activities which fall in the top right sector of the graph will be the ones to prioritise.

Hopefully the number of factors falling into the ‘area of focus’ sector is small enough for these to be the key issues which will drive both the tax strategy and the actions of the tax function.

Once the tax strategy has been drafted, we suggest it should be subjected to a challenge process, probably using a second party (maybe an external tax adviser). Part of this may entail challenging what is present and what might be missing, but the real value a second pair of eyes can add is in forcing the owner of the strategy to be realistic about what will be achievable and to set focus and priorities accordingly. **focus and priorities accordingly.**

## Objectives

The tax strategy needs to be a high level document, which will probably cover a multi-year timeframe, but at the same time it has to be supported by appropriate objectives and tactics. In order to ensure that the tax team and individual team members are working to implement the strategy, team and staff objectives will need to connect to and stem from the strategy.

In our experience where there is a high-level tax strategy in place, the day to day activities, and in some cases even people's individual objectives, are often fairly disconnected from the overall strategy. We see making this connection as one of the key challenges for a best practice tax department.

Good objectives will of course provide the 'milestones' against which effort to achieve the aims of the tax strategy can be measured. The classic test of effective objective setting is whether they are 'SMART', in that they are:

**S**pecific  
**M**easurable  
**A**chievable  
**R**esults-orientated  
**T**imely

We see no reason why tax objectives should be any different.

## Making it happen

The most important thing is that the strategy needs to be 'lived'. We regularly observe groups that set strategies/plans/objectives, but then a year later come back and explain that they have failed to achieve their aims because 'events intervened'. Of course events will nearly always intervene. Which tax person has not been driven away from the overall strategy by a transaction where advice has been needed in a hurry or a computation which needs submitting before a deadline? However a realistic strategy will allow contingency time/resource for the unforeseen.

Achieving the tax function's strategic goals will nearly always also depend on the actions of others. At the very least this requires good communication of what is required of the others. There may be some organisations where a single memo will do the trick, but probably not too many. In most cases much effort will be needed to get 'buy-in' and commitment from those on whom the tax function will be relying in order to achieve its goals.

However what is just as important is to keep a discipline of checking progress against the strategy. We would suggest regular (monthly?) checks. Where we see regular checks happening they are often on an annual basis and we question whether this is often enough. (Regular and frequent checking is also a good discipline for members of the tax department to ensure they keep to their own personal and career plans.) This will ideally involve setting some key milestones against which to check progress. *(More on performance metrics in Section 13.)*

## Action plan

- Agree the need for a strategy.
- Identify interested parties.
- Identify key issues, opportunities and risks.
- Draft, debate and agree the strategy.
- Communicate the strategy and ensure buy-in.
- Link it to team and individual objectives.
- Set and monitor key milestones and measures.





# 04

## The role of the tax function

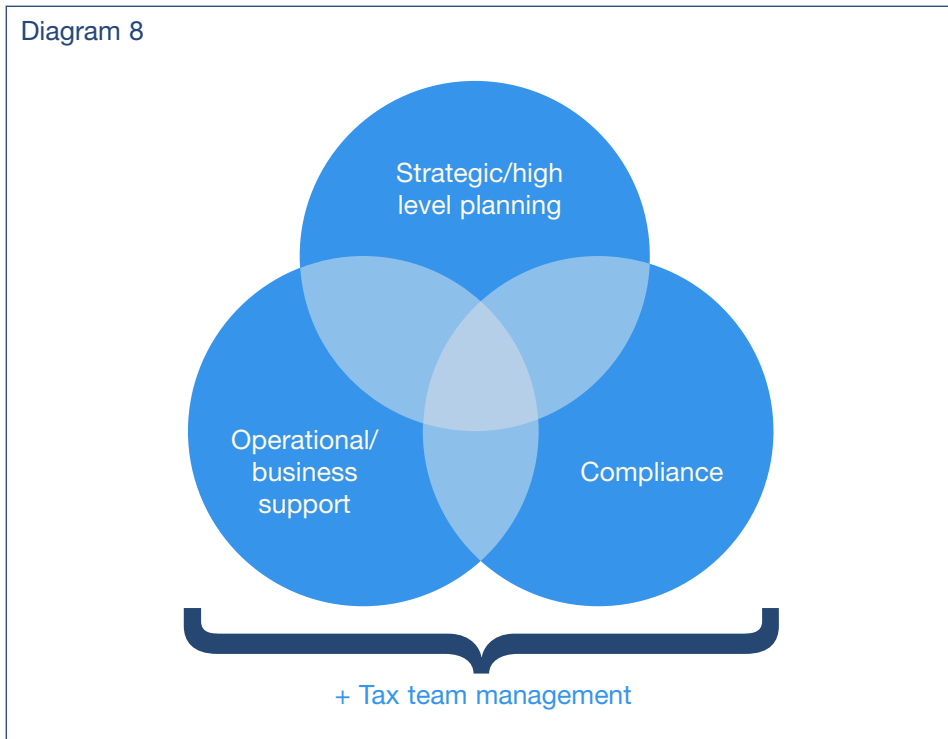
We have seen a significant number of tax functions whose role seems to be perceived as “to deal with anything that is in any way related to any issue around any tax”. This is clearly not a great recipe for success in a business looking to pursue a clear tax strategy.

Therefore a clear definition of roles and responsibilities is important to ensure that the tax function focuses on the issues identified in the strategy. Otherwise the business’ expectations of the tax function will extend to everything even vaguely related to tax and the function will inevitably struggle to meet expectations.

to split the activities into three ‘domains’; strategic/high level planning work, work in supporting the business and, of course, compliance work. There is also a fourth ‘domain’ into which successful tax departments direct some energy, this being the time spent managing the tax function (and resources) itself.

When analysing the role of the tax function we have often found it helpful

The role is illustrated in *Diagram 8*.



To give some examples of the sort of activity that might fall within each of these domains:

Strategic	Business support	Compliance
<ul style="list-style-type: none"> <li>• Group tax strategy</li> <li>• ‘Blue sky thinking’</li> <li>• Political/industry lobbying</li> <li>• Major tax driven business re-organisation</li> </ul>	<ul style="list-style-type: none"> <li>• Building a tax aware group culture</li> <li>• Group tax communication</li> <li>• Tax technical &amp; transactional advice and support</li> <li>• Tax scheme evaluation and implementation</li> <li>• Product tax (for example for financial services businesses)</li> <li>• Tax data and knowledge management</li> <li>• Tax forecasting</li> </ul>	<ul style="list-style-type: none"> <li>• Tax risk management, controls work and self-audit</li> <li>• Tax accounting</li> <li>• Group tax compliance management</li> <li>• Multi-territory tax control</li> <li>• Entity tax compliance management/ detailed work</li> <li>• Data collection</li> <li>• Routine business queries</li> <li>• Revenue enquiry management</li> </ul>
Tax team management		
<ul style="list-style-type: none"> <li>• Staff coaching, performance management and development work</li> <li>• Resource allocation and budgeting</li> <li>• Recruiting</li> <li>• ‘Away days’ and other motivational and team building activity</li> <li>• Management of advisers</li> <li>• Liaison with business and finance colleagues regarding their use of ‘shadow’ tax resource</li> </ul>		

The above is not just an academic analysis. It is a framework we have used with a number of businesses to help them clarify the role of their tax function and their future areas of focus.

As *Appendix II*, we include a copy of a worksheet which analyses the above areas of activity in some more detail, and encourages tax functions to assess firstly how they currently divide their time between them, and secondly how they would aim to allocate their time going forward. The document was prepared for use with companies looking to reduce the proportion of time spent on

compliance activity and re-focus resource on higher value-adding activity. This is a general trend we are witnessing.

### Agreeing areas of focus and responsibility

Few tax functions are likely to have the resources to enable them to address all the activities in the table set out above. We see and hear about demand for tax services from customers commonly outstripping supply; tax departments are very often resource constrained. Therefore when the tax function is planning the resources it needs and how it will use

these resources it will need to consider whether various activities:

- must be done at all (are there any low-value, low risk activities that can be jettisoned?);
- can best be done by somebody else (by the shadow tax department, an external adviser, an outsource service provider, or by delegation of responsibility to business units); and
- can be done more effectively (by process streamlining or use of new technology).

The roles of the shadow tax department and external advisers are dealt with elsewhere. However one key issue that we are discussing with more and more tax directors is whether some of the lower value work they and their teams do (typically compliance work) really is an appropriate use of their resources – often highly trained tax specialists. They regularly explain that they recognise the work itself is low-value adding, but that it serves as a key interface with people in the business and therefore it has to be done the way it is in order to preserve relationships and help detect high value/high risk issues.

Undoubtedly undertaking such low-value work can serve as an interface. However the real question to ask is “could we achieve the same benefits through other more effective and less time consuming ways?” Of course compliance data gathering can be used to ensure ‘face time’ with business and accounting staff, but there may well be better ways of achieving this. In particular, compliance data gathering normally takes place after the year-end and therefore is hardly the most effective ‘early warning radar’. If the tax function’s main contact with the businesses is when it is pressing it for low-level information analyses, this also may not do a great deal for the tax function’s reputation and stature within the business.

There will usually be some politics and diplomacy involved here. In particular, emerging tax functions may find they have to take on some drudge or off-strategy tasks in order to preserve relationships or gain access to particular individuals. More established or high profile tax functions are more likely to be able to resist this and therefore avoid having to take on, for example, compliance

data gathering work or to serve as personal tax advisers on the directors’ own individual tax affairs.

Once the focus of effort and allocation of internal and external resource has been decided, it is then very important that roles, responsibilities and approaches are clearly communicated to all involved. If this is not done properly, the tax function risks being bothered with inappropriate issues, and then being seen as unhelpful when customers have to be turned down or directed elsewhere. In a best practice scenario we would recommend agreeing and communicating internal service level agreements with business units, other central functions and any other involved parties.

## Action plan

- Agree roles, focus and priorities.
- Agree respective responsibilities.
- Ensure communication with interested parties.
- Consider service level agreements with ‘customers’ and information providers.





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# Managing the tax charge

The next three sections focus on the three areas we believe a tax function can control. These are the tax charge, tax risk and the costs of managing the tax position – the three scales on the tax strategy template.

## What tax charge are we talking about?

Our experience is that many heads of tax believe that senior management's main focus is normally on the accounts tax charge ('book tax') and the impact it has on earnings per share. The main exceptions to this are businesses that have a strong cash-flow focus, where cash tax obviously comes to the fore.

Increasingly though, business analysts are focusing on the cash tax charge, as shareholder value analysis shows that this is much more highly correlated with a company's shareholder value. Some tax functions do actually use shareholder value analysis as a decision tool to assess the potential benefits of various tax management/planning activities.

## What taxes?

Corporation tax/corporate income tax or other below the line taxes are normally the taxes which 'stare out' from a set of accounts. Above the line taxes such as VAT, import and excise duties, and (increasingly) environmental levies are of course also taxes on the business. The above/below the line question is particularly pertinent when agreeing respective responsibilities between the tax function and the businesses – with local businesses often being judged on a profit before tax (PBT) measurement, which is calculated after charging all the above the line taxes, but none of those below the line.

We are aware of a number of significant sized businesses where even very senior management is rewarded on a PBT measurement – including, more often than not, the head of tax! This is hardly conducive to proactive management of the tax charge.

## Who 'owns' the tax charge?

Is it the tax function or is it the businesses themselves? Obviously the answer to this question has major implications for the way in which the tax function operates. If it is the responsibility of business managers to manage the tax charge, then it is more likely that the tax function will function as a 'service provider' to the businesses, albeit hopefully as a fairly pro-active service provider. The tax function may also need to take on a role of central co-ordinator, ensuring consistency between the various businesses and perhaps encouraging the businesses through monitoring and publicising their respective tax performance. If the tax function 'owns' the tax charge then more of a leadership role will be called for, with the tax function taking responsibility for driving tax performance in all the businesses.

In our experience the ownership of tax is often a mixture of the two – and this is probably the practical answer. Few tax departments have full ownership of all tax matters at group, head office and local level – in particular where there are overseas subsidiaries (see *Section 14*).

However this can often lead to expensive tax planning taking place that has a local benefit, but no overall benefit to the group as a whole. We do see a trend here though, in that the increasing move towards global management of businesses is reflected in a trend towards stronger head office tax function control of overseas tax affairs.

Additionally in companies where VAT, or other sales taxes, are a major cost we often see these taxes being given rather less attention than they deserve. The ownership of these taxes is often given either to the businesses or to more junior people in the tax function. As a consequence, we often find that the management of such taxes suffers from a lack of co-ordination between different territories.

## Is the tax charge manageable?

Linked to the question of ownership/responsibility is the need for recognition that the tax charge, or at least significant components of it, is actually manageable. To tax directors this will (hopefully) seem too obvious to merit mentioning. However it is surprising how many business managers, and some at fairly senior levels, have told us that tax is an area they have never really previously focused on – with the whole business emphasis being on the profit before tax.

We frequently see senior management devoting a great deal of attention to managing operational aspects of the business, but viewing the tax function essentially as an overhead. Getting senior management to focus on tax as a manageable component of shareholder value can be a powerful way to raise the profile of tax in the business. Often, the first time senior management really think deeply about the impact of tax is when they become involved in helping set the tax strategy.

Some elements of the tax charge are obviously going to be more manageable than others. Clearly if a government changes the tax rate then the tax charge will probably change too. However some heads of tax/CFOs do seek to manage this through their involvement in political and industry lobbying work. Other 'drivers' of the tax charge may be easier to manage. Therefore understanding the key manageable components of the tax charge, and then managing the related drivers, will be key. Some tax managers speak highly of the benefits of presenting to business management on key tax drivers and future tax forecasts.

Simple overviews such as graphical representations of the reconciliation between the 'book' and statutory or 'natural' tax rates can be very powerful tools.

## Past, present and future

An interesting question to ask a tax function is "What respective proportions of time do you believe you devote to negotiating prior years' tax liabilities, computing the current year's liability and managing future liabilities?" Most will admit that they are not devoting as much time to the future as they should be. (The Cranfield surveys show that most

tax functions still spend the majority of their time on compliance work.) Again, this is an area that should perhaps be addressed in the tax strategy.

Tax forecasting will often be an important aspect of managing the tax charge. This will require a good understanding of the key drivers that will affect the group tax charge. We would suggest that, in a best practice tax department, the head of tax can readily answer the following four questions:

- What will the anticipated group tax charge be over the next three (or even five) years?
- Which are the main territories in which the largest part of the group charge will arise?
- What are the (three or four?) key tax issues in those territories? and
- Where are the group's key tax assets (e.g. tax losses carried forward, uncrystallised losses etc.)?

The answers to these four questions will not only be needed for cash flow forecasting, but will also be useful if determining where tax planning effort should be directed and the resources needed to do this planning. They also often highlight the important issues that external auditors will want to focus upon.

## The total tax contribution

Since producing the first edition of this guide there has been an increasing focus on a company's total tax contribution. Companies pay corporate income taxes on their profits. But corporate income taxes are not the only taxes that are levied on companies. Social security contributions are a feature of all developed countries' tax systems and add significantly to business tax costs.

## A powerful message

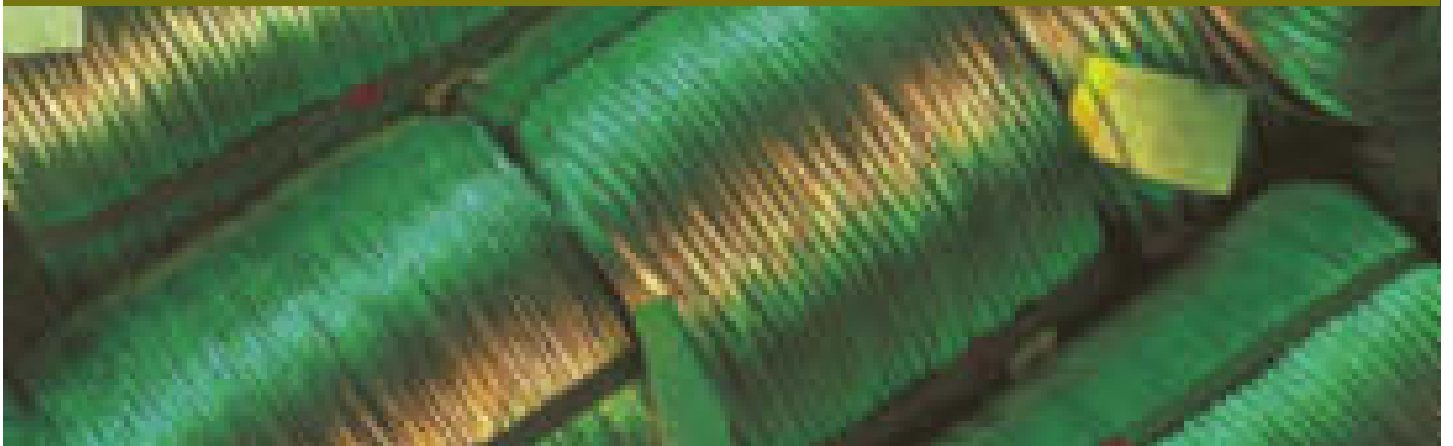
- Use shareholder value analysis to model the impact a certain variance in the cash tax charge will have on the share price/market capitalisation.
- Contrast the change in product sales that would be needed to achieve an equivalent change in shareholder value.

In the UK for example, the contribution overall in employers' national insurance contributions is comparable to that of corporation tax. In countries such as Germany and France, the contribution is vastly higher.

When considering the overall tax burden on business we also have to look at such things as business property rates, irrecoverable VAT and sales taxes, and other more specific business sector taxes. Multinational companies obviously operate across a number of countries and the total tax contribution should be calculated on an international basis. Attempting to add the figures together to calculate the total business tax contribution is difficult and the data is not easily available. There are also arguments as to what exactly should be included. But the result should be a clearer picture of what a company contributes in taxes – and hence what taxes could (or should?) be managed. Of course as well as providing a useful base for tax management decision making, total tax contribution information can communicate some powerful messages in both internal and external reporting. Why should companies not get public credit for the taxes that they pay?



“We frequently see senior management devoting a great deal of attention to managing operational aspects of the business, but viewing the tax function essentially as an overhead.”





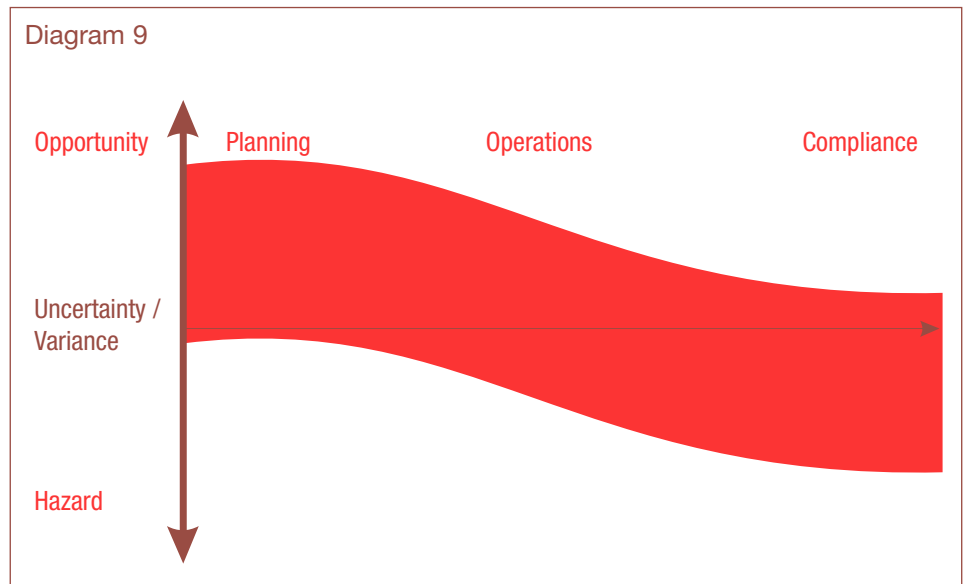
# Managing tax risk

The second scale on the tax strategy template is tax risk. This is not always something one should avoid. Uncontrolled or unidentified risk is clearly undesirable, but there will probably be occasions when a head of tax will want to take calculated (legitimate!) risks. Winning in business is often about taking risks – and managing tax is no different.

## Areas of risk

When looking to identify tax risk, it can be helpful to use a similar 'planning – operational – compliance' framework to the one used to summarise the tax function's roles (see *Diagram 9*).

- **Planning risk** – risk arising from tax planning activity (where there can be considerable 'upside' risk or opportunity). In such situations there is often little downside risk apart from the costs of implementing the planning and getting it agreed by the appropriate tax authorities.
- **Operational risk** – risk arising from the operations of the business units and the extent to which their activities may give rise to unexpected fluctuations in the tax charge. This can involve upside risk where there are potential planning opportunities or more tax effective business decisions could be made. Equally there will be downside risk where business decisions may be sub-optimal from a tax viewpoint.
- **Compliance risk** – risk of additional liabilities or penalties arising through non-compliance or failures in the tax return process.



As with the earlier 'roles' diagram, these areas of risk are interlinked. If planning activity is to be successful, clearly it will need to be properly reflected in subsequent tax returns and agreed with the tax authorities.

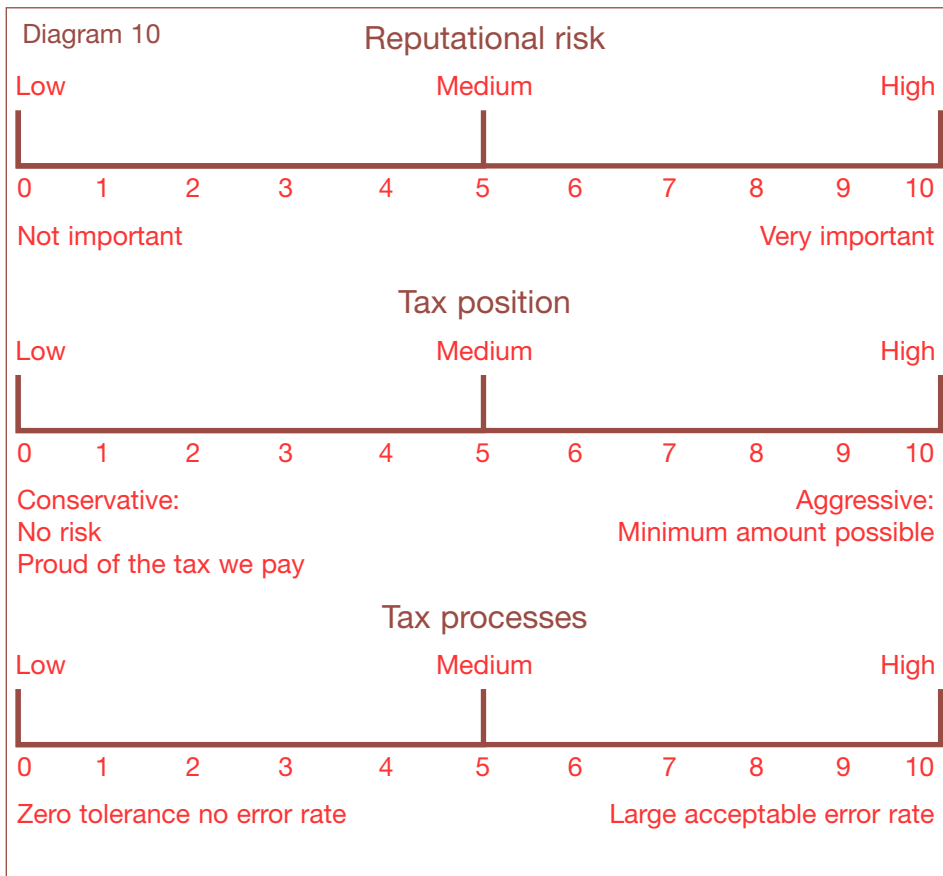
## Taking risks – managing the opportunities

When looking at tax planning activity in particular, it is good practice to clarify the likely level of both upside and downside risk. This can then be compared with the group's position on the risk scale of the tax strategy template or perhaps on a more detailed map of the group's preferred

approach to tax risk such as *Diagram 10* illustrates.

Once a planned activity is included in a tax return, how will it change the tax authorities' view of the group? How does what is planned lie with the group's approach to risk generally (i.e. not just to tax risk)?

Sometimes, tax risk also needs to be looked at on a portfolio basis. If the group faces a large number of relatively moderate risk issues, does the aggregation of risk result in higher overall risk? Could the group cope if disputes or enquiries arose on a significant proportion of issues, or



- tax controls, review, self-audit etc.;
- tax knowledge within the business; and
- tax sensitive accounting and transactions.

Often it is only when we get into discussion of some of the more important items on this agenda that it becomes apparent why risks are not being managed as effectively as they should be.

## Risk mapping

As a discipline for helping manage tax risk, cataloguing known or potential tax risks (both upside and downside) and then mapping these against methods by which the risks are controlled can be very helpful. Improvements to controls can then be planned and prioritised. As with tax strategy, the potential economic impact and the probability/ease of success should be used to assess prioritisation.

would the tax function become overwhelmed? What would be the accounting impact if a number of risk issues all materialised at the same time?

## Tax risk review

Traditional tax risk reviews have focused primarily on 'tax technical risk'; for example risk of missed time limits, mis-recording of transactions or of failed tax planning schemes. There are many such areas where things can go wrong, or lead to sub-optimal performance and most tax functions have a fair idea of where these risks will lie. Understanding where these risks are is important, but in order to be able to manage the risks more effectively, it is normally important to look at why the risks arise. In other words, to look at the causes of risk, not just the symptoms.

A typical discussion agenda we have used when discussing 'causes of risk' with clients would be:

- tax strategy and objectives;
- senior management approach to tax management and risk;
- attitude to tax risk – and resources devoted to it;
- international tax management risk;
- quality and quantity of resource;
- workload and prioritisation;
- communication;
- tax planning activity;
- relationship with the tax authorities;
- tax systems and procedures;
- quality of underlying financial systems and information;

In terms of good corporate governance, risk mapping does not just help manage risk, it helps evidence that it is managed. Risk maps can prove very useful in the case of review by Internal Audit (who might also help develop them) or indeed by the tax authorities. Depending on the relationship with the tax authorities, it may be worth considering sharing a risk map with them or indeed co-developing one (getting the tax authority to work for you, for free!) Certainly in the UK some tax inspectors actively seek to involve tax functions in their risk analysis work, furthering the UK Inland Revenue's ethos of 'voluntary compliance'.

## Benchmarking

For planning risk in particular, it is common for businesses to look at the approach that competitors or other comparable businesses take to planning risk and to particular types of tax planning activity (“would our competitors do this?”) Knowing what transactions and risks your competitors face can of course be difficult. However we do see many groups that have a good knowledge of competitor activity through industry groups, friendships and from recruiting staff who previously worked elsewhere in the industry concerned. In some industries, competitors are actually quite open in discussing industry tax issues amongst themselves, feeling that there will be a net gain to all the competing businesses resulting from collaboration.

## Some practical steps

Here are a few steps we have seen taken by companies working on improving their tax risk management.

### Agree ‘materiality’ limits

Consider clarifying the group’s approach to downside risk by setting out maximum acceptable cash adjustments stemming from control weaknesses, process errors or technical error, then agreeing these limits at a senior level. Discussions around these limits with the Board or Audit Committee can be helpful in agreeing the appropriate level of resource for the tax function.

### Address accounts coding risk

Mis-coding/mis-analysis of expenditure is a perennial problem for tax functions. Accounts clerks are often not highly motivated to get things right from a tax perspective and can be a fairly transient

workforce. Where they encounter expenditure which is a little out of the ordinary, it is far easier for them just to post it to a common accounts code than to research exactly how it should be treated. Alternatively they may just post it to other/sundry/miscellaneous and leave a (far more expensive and time-constrained) member of the tax team to sort things out. Production of a basic guide to the coding of tax sensitive expenditure can be a very worthwhile exercise. This would sensibly include guidelines on when to seek help and/or a formal escalation and sign-off process for significant risk items. These are also useful controls to evidence to the tax authorities. Tax awareness roadshows or training sessions for such staff can also be very worthwhile, though they do need to be repeated regularly if they are to have an ongoing impact.

### ‘Self audit’

In the same way that audit methodology has shifted away from detailed substantive work towards placing a greater reliance on systems and controls, tax functions are typically cutting down the detailed analysis work they have done in the past and instead devoting more attention to controls and procedures. Where controls are being relied on, it does of course become necessary to test that they are continuing to operate effectively. This might involve devoting a greater proportion of tax team time to ‘self policing’, or it might be that this work can sensibly be passed over to Internal Audit or to external advisers.

## Action plan

- Catalogue tax risks.
- Map existing control mechanisms against risks identified.
- Plan improvements to controls.
- Prioritise improvements.
- Timetable subsequent risk review assignment.

## Use of technology

HM Revenue & Customs (HMRC) and other tax authorities are making increasing use of data mining tools in their audit and enquiry work. Conducting a similar exercise in-house (albeit probably requiring input from specialist advisers) is likely to ensure problem areas are identified and resolved before they are spotted by the tax authorities, and may also identify additional tax savings as well as managing the downside risk.

## Post transaction documentation review

We imagine that most readers of this guide will have seen cases where technically sound tax planning work failed, or was put at risk, due either to problems with implementation or the documentation of the transactions. High level planning only works if the tax authority agrees the resulting tax returns – and they will often ask to see the underlying documentation. Having a tax investigations specialist (typically an ex-tax inspector) review documentation and feedback on risk issues can be very revealing. For major tax planning transactions we would recommend this as something that should be undertaken as a matter of course.

As noted in the preface to this second edition, tax risk management has moved on considerably over the last few years. We would also refer you to our separate guide *Tax risk management*, which was published in 2004.

## Consider outsourcing

There are areas of risk that will be avoided or reduced if the related activity is outsourced to a specialist service provider. Certainly in the UK, as the advent of corporate tax self assessment has created concern that it is now easier for companies to fall foul of the new procedures and compliance obligations introduced, a number of companies have decided this is the ‘trigger’ for compliance outsourcing.

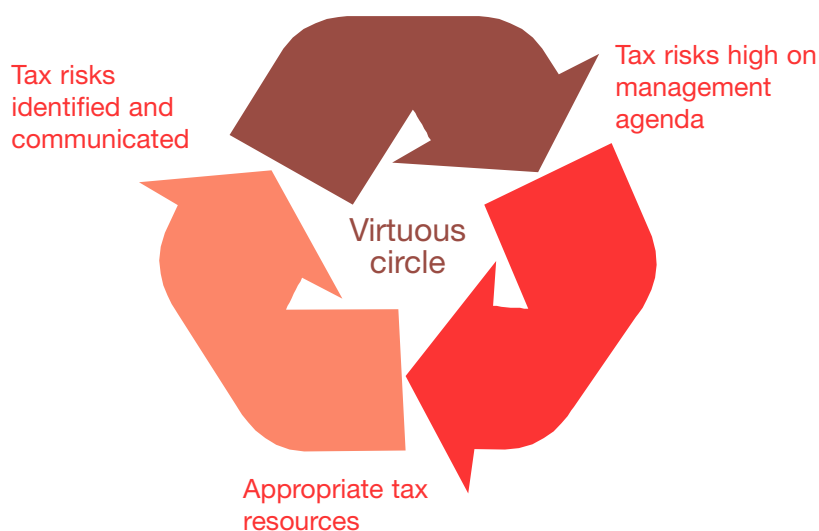
## Tax risk aware culture

We regularly notice a ‘multiplier effect’ or ‘virtuous circle’ following risk management work. Particularly where the work involves people outside the tax function, it will often serve to get tax issues, and in particular tax risks, high on their agenda, which is likely to help uncover more risks and opportunities. The more of these that become evident, the greater profile the tax function will have, which in turn may well lead to more appropriate levels of tax resource (see *Diagram 11*).

Clearly it is not possible to control all risks or even reduce them to an absolute minimum. Tax risk is something that should be managed, not eliminated. Cost/benefit analysis and prioritisation will apply. However the ‘cost’ will not usually be pure economic cost.

The ethical, professional and reputational cost of tax risks is also an important factor. Equally important to remember is that tax risk is not all one way. There are downside risks in managing tax, but there are upside opportunities to be managed as well.

Diagram 11







# Managing the cost of the tax function

## What does the tax function actually cost?

Our experience is that few companies have an accurate picture of the costs of their various tax management activities. The tax function budget may be a good starting point for assessing costs, but it is unlikely to provide the full picture. Costs to take into account will include:

### Direct tax function costs

These include salaries, benefits, social security costs, pensions, profit share and employee taxes. It may also be necessary to factor in recruitment, severance, training etc. not forgetting the cost of temporary staff. Overheads and other central costs will also be part of the picture. As a rule of thumb, our discussions with businesses suggest that the full cost of an employee is often over 200% of their base salary.

### Shadow tax function costs

Staff outside the tax function will also usually carry out tax work. Typically a major part of this will consist of recording, analysing and supplying tax information to and answering queries from the tax function, but it will also include dealing with tax returns on VAT, sales taxes, duties and payroll taxes. The accounting, finance, legal, treasury and management information/IT departments are areas where significant shadow tax function costs often lie. Our experience is that these costs regularly exceed the tax function's own internal costs, and are almost always much higher than the tax function believes them to be. However very few businesses have attempted to quantify the costs of the shadow tax function.

## Advisers' fees

External advisers' fees are probably relatively easier to ascertain than the costs of the shadow tax function. However where individual business units/subsidiaries (and in particular those overseas) are permitted to instruct their own advisers, it becomes increasingly difficult for either the tax function or the CFO to keep a good picture of what is being spent and where. Things can get even more complicated where different advisers are used in different territories.

## Senior management time

Finally there is the time spent by senior management, typically the CFO but increasingly the Board as a whole, in discussing the tax strategy and keeping an overview of how the tax position is being managed. Our experience is that this is often rather a modest cost, and one that companies would sometimes do well to increase!

## Managing costs

This guide is written at a time when businesses are focusing on cost cutting, and particularly on cutting the cost of 'back office' operations, with an increasing focus on core activities. Managing costs is clearly an important issue for most tax functions.

However businesses must bear in mind that the manageable elements of the tax charge and tax risk may be far more significant than the costs of running the tax function. The biggest achievable cost savings may well be in respect of reductions in the tax charge, not in the tax function's budget. The purpose of having a straight line result on the strategy template (see *Section 3*) was to show the correlation between the costs of managing tax and the ability to manage both the tax charge and the tax risks.

The UK Government launched a 'Spend to Save' initiative where they increased resources available to the UK tax authorities in order to increase tax revenues. Companies looking for 'bottom line' cost cutting may need to consider mirroring this approach. However one of the big issues for tax functions is that the benefit they add is often below the line, whilst their costs are charged above the line in arriving at the profit before tax. We are aware of significant tax planning initiatives being rejected solely on these grounds.

Tax function costs depend on three basic variables:

- The volume of service delivered to the business.
- The price of inputs (principally staff salaries and advisers' fees).
- The efficiency with which services are delivered.

If costs are to be cut, tax functions need to:

- do less (usually by cutting headcount), and probably therefore having to gain consent from the businesses that they will henceforth receive a lower level of service;
- convince staff/advisers to accept lower salaries/fees; or
- look for opportunities to improve efficiencies.

There is perhaps a fourth option of moving costs/activities out of the tax function onto somebody else's budget in the company, but clearly this is a political rather than a real cost saving.

In terms of reducing levels of activity, it may be that there will be some potential to jettison some non-essential activities without having

a major impact on the value added to the business. The tax strategy should clarify those areas of activity that the tax function will focus on and those it will not. Indeed putting a tax strategy in place and agreeing areas of focus may well highlight which current activities are adding least value to the business – with the resultant changes leading to cost savings.

It may be possible to cut salaries without a reduction in service levels, primarily through ensuring the staff mix is right and avoiding the use of overqualified staff for junior level work. It may also be possible to cut advisers' fees through more careful scoping of their work, requiring improved efficiency or through 'bulk buying'.



## Improving efficiency

While better focus will normally lead to significant improvements in effectiveness and/or cost savings, savings can also be achieved by improved efficiency, which is illustrated in *Diagram 12*.

## Effective process improvement

Effective process improvement normally involves addressing a combination of:

- people issues;
- process design; and
- technology solutions.

Our experience is that successful projects do not focus on just one of these aspects in isolation of the others. We recommend that the planning for any process

Diagram 12

	Potential for cost saving	Ease of achievement
Process streamlining	Basic	Normally requires significant time investment to build, implement and maintain new processes
Process standardisation	Improved	Can involve significant cultural change as well as process design, implementation, and maintenance
Outsourcing	Most significant	Easy to achieve by leveraging off the investment made by the service provider

improvement project should address each of these aspects in turn.

From experience, we would raise a particular note of caution regarding internal process improvement/streamlining work. Tax directors normally have a good understanding of the steps that need to be taken to improve tax processes, but few such initiatives prove successful in delivering significant process improvement. Very few tax functions have spare resource to devote to process improvement work and, even where they do, events nearly always intervene such that other work ends up taking priority ('too busy to be efficient').

Here we have to declare an interest, given that PricewaterhouseCoopers is the leading tax outsourcing service provider. Nevertheless, does it really make sense to invest in in-house process improvement, 're-inventing the wheel' rather than leveraging the existing processes and tools that an outsourcing service provider has already developed? What does make sense is for the tax function to ensure they only start their compliance work when the business unit has provided data in the right format as required by the tax function. We have seen many cases where highly paid tax people are carrying out data collection,

analysis and reconciliation work, which in our opinion really should be carried out in accounting functions.

The greatest potential for improving efficiency will normally be in relation to tax compliance work, given that this has significant process based elements and typically makes up a large part of a tax function's (and shadow tax function's) workload. However there may also be potential for improvement in research and planning work, not least using new technologies (internal or external) to access ideas, precedent and advice.

## Cost versus benefit

When seeking to control the cost of managing the group's tax affairs, it is important to distinguish between measures to improve efficiency and measures which reduce the level of service the tax function delivers. Nobody is going to argue against improved efficiency, but if cutting the cost of the tax function results in a higher tax charge or greater tax risk, the net result may be a reduction in shareholder value. Having a proper tax strategy in place will help ensure that the tax function receives the appropriate level of resource and that the business gets value for money from the tax function.



# Tax department organisation

One of the questions we are regularly asked, both by international and by domestic tax directors, is “How can I best organise my tax department?”

Our first response will always be to ensure that the group is clear about its tax strategy and the tax function’s role, as there is little sense planning the structure and organisation of a department until it is understood what the business requires of it. Having said that, we see two basic models, the ‘head office model’ and the ‘business unit model’. Let us start by explaining these two models and the pros and cons of each (*Diagram 13*).

In the ‘head office’ model, the tax function would be highly centralised with only limited tax resource present in local businesses. In the ‘business unit’ model, local businesses take responsibility for their own tax affairs and normally have in-house tax resource within the business. Any central resource would be used as ‘adviser’ by the local business in-house tax resource, rather than having direct control over the business units’ tax affairs.

The recent trend towards establishing global/regional shared service centres (SSCs) for accounting and finance services creates an added complication, because there are also arguments for situating tax resource close to finance information and systems in the SSC. Whilst we have had discussions with a number of groups on this issue, we have yet to witness any clear trends here.

## What is right for you?

We have seen a large number of both models, as well as some hybrid structures. So which one is right for you? Again, this will depend on the business’ tax strategy and key tax drivers, for example:

- if the group has been set up (e.g. contract manufacturing) such that transfer pricing is the key issue or, alternatively repatriation of cash to head office territory is the main business driver, then group co-ordination will be one of the key drivers for the in-house tax department. This naturally leads to the head office tax department model;

- if however the group tax charge is very much driven by the tax charge in one or two major territories, then being close to the business in those territories and having strong local tax skills will be vitally important and this may lead to the business unit model.

Groups using the head office model do sometimes strengthen links with the businesses by ‘man-to-man marking’, where individuals in the head office function are each charged with ensuring that particular businesses and/or locations are properly supported.

In our experience, whichever model is used, the senior person either at head office level or in individual territories is usually a person skilled in corporate tax affairs. However in some business (e.g. financial services) the corporate tax (on profits) can be dwarfed by, for example, indirect taxes on expenditure. The business unit model whereby there might be an indirect tax person in every territory reporting through to a corporate tax person, can lead to situations where the most significant tax of

Diagram 13

	Advantages	Disadvantages
Head office model	<ul style="list-style-type: none"> <li>• Strong focus on group tax charge</li> <li>• Easier to align with group strategy</li> <li>• Good co-ordination</li> <li>• Easier to restrict headcount</li> <li>• Provides a pool of expertise</li> </ul>	<ul style="list-style-type: none"> <li>• Can be seen as remote from businesses</li> <li>• Will not have detailed territory specific skills for overseas entities</li> <li>• Can be perceived as a ‘head office overhead’</li> </ul>
Business unit model	<ul style="list-style-type: none"> <li>• Close to business</li> <li>• Likely to have local-territory specific tax skills</li> <li>• Can reduce reliance on local advisers</li> </ul>	<ul style="list-style-type: none"> <li>• Less focused on group co-ordination or strategy</li> <li>• Can lead to inconsistent positions with different tax authorities</li> <li>• Transfer pricing can be difficult to co-ordinate</li> <li>• Harder to supervise activity and control group tax costs</li> <li>• Reporting and/or loyalties will often be to local management</li> <li>• Harder to ensure optimum resource levels</li> <li>• Tax staff in smaller locations can feel isolated</li> </ul>

the group (indirect tax) is not being effectively managed or co-ordinate.

What is clear is that there is no single best structure for all tax departments. The structure needs to fit the requirements of both the business and the key tax issues that the tax function wants to manage. Whichever model is adopted, it will also be important that 'dotted line tax reporting' and consultation is also maintained between the tax function (wherever situated), head office and the businesses (see *Section 9 on Communication*).

## 'Shadow' and external resource

The tax function should not just be thought of as those staff sitting in the in-house tax department, but rather to include 'shadow tax function' staff based in other areas of the business and also external tax resources. Different businesses use very different mixes of in-house, shadow and external tax resource. There seems to be no single best practice model here, other than in locations where the group only has a small presence, where the lack of 'critical mass' internally will mean that external resource will almost always be required. Nevertheless the relationship with shadow staff and procedures for engaging external resource will need to be addressed when planning the tax function structure.

## Reporting lines

Where should the tax function sit in the group's departmental structure? Again, there is no clear cut answer. There are though some interesting cultural differences here. For example in the UK, the tax function will commonly be allied with the finance or treasury functions. In the US it seems more common for tax to sit with the legal department. This

typically also influences the type of staff employed in the tax function.

Historically, tax staff in overseas subsidiaries have normally reported to their local CFOs, albeit with 'dotted line' reporting to the global head of tax. However as the trend towards global management grows, direct reporting to the global head of tax is on the increase.

There is also a clear trend away from the tax function as a 'back-office' function whose role was to give technical opinions and to complete tax returns. Tax functions are now much more involved with the businesses, ensuring effective implementation of planning initiatives, working with accounting and systems people to ensure effective tax controls and working to raise the level of tax awareness in the business.

## Flexibility

Historically, tax functions have typically been organised around the structure of the business. However as the rate of corporate change accelerates this is increasingly less sensible and less common. When corporate structures were relatively stable, mirroring their structure in the tax function was logical enough. Nowadays the rate of corporate re-organisation, merger, de-merger and re-engineering means it is often more sensible to have a small flexible team which will be well placed to adapt to (and indeed influence) future changes in corporate structure and can marshal additional tax resources as required.

## The head of tax

The role of the head of tax is perhaps worthy of specific mention. In best practice tax departments, the role encompasses:

- developing and implementing a tax strategy;
- being a business advisor to senior management;
- having an international focus;
- being an ambassador who champions tax within the business; and
- managing the tax function – although we have even seen this delegated to a deputy.

The skills required include rather more than just tax technical ability, and in some of the larger tax departments current tax technical knowledge is probably fairly low on the list of what a business looks for in its head of tax (*more on skills in Section 10*). We have come a long way from the days when a head of tax was expected to spend his days with his head buried in tax legislation.





# Communication within the business

“like technicians”

“need to give practical answers not caveated opinions”

“only come to me to ask questions (too many)”

“need to understand the business issues more”

“should get out more”

*... all real quotes taken from a survey of a business' view of its in-house tax team.*

However strong the skills of the tax team, it is unlikely to perform effectively if it does not manage its relationship with the business properly. This will involve regular, quality communication. If a business' main contact with the tax function is in connection with provision of data and answering low-level questions relating to tax return preparation, the relationship with the tax function will probably not be a very strong one or be at the right level. Part of the tax function's plan or team 'job description' should be a section addressing how the team will maintain effective communication with management, the businesses and other key customers and information providers (and possibly also with external advisers).

## Who to communicate with?

Any communications plan will need to identify who the tax function's main contacts should be. These might include:

- the Board and other members of the executive and senior management. (Often a seriously neglected area);

- the people who run the business units – and are making decisions, on a day to day basis, where proper tax input is important;
- key 'customers' and providers of information such as the finance, treasury, legal, property, information systems and human resources departments;
- external advisers;
- other industry heads of tax and tax teams;
- the tax authorities; and
- risk management and internal audit.

## How to communicate?

Some ideas we have seen that have improved communication with the business include:

- circulating the tax strategy – or even better, presenting it to interested parties;
- scheduling regular update meeting with key contacts;

- a brief one page tax summary included in the monthly main Board papers, highlighting key tax issues;
- tax customer user groups;
- a tax sub-committee of the Board;
- soliciting feedback on service quality by way of customer satisfaction surveys;
- tax awareness meetings;
- 'man-to-man marking', where each member of the tax team has a set of contacts (s)he is responsible for keeping in touch with;
- periodic awareness updates, each built around a particular (easy to remember) theme;
- published 'league tables' of business units' own individual tax performance;
- speaking slots at business and finance 'away-days' or conferences;
- publishing flyers, contact cards, tax helpcards etc. which staff can keep handy or pin up by their desks;

- tax pages on the corporate intranet; and
- use of other technologies such as webcasting, video conferencing etc.

The important thing is to have a communication programme which fits in with the communication culture of the business.

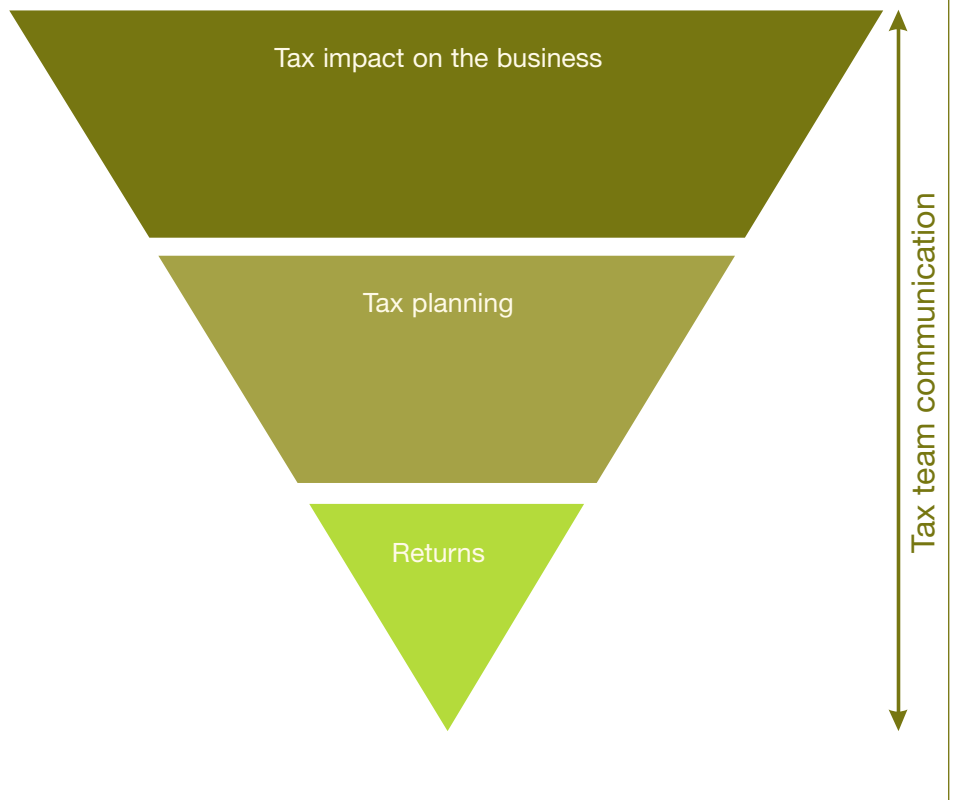
### Communication within the tax team

We have found that tax functions often benefit from a review of their approach to communication within their team, particularly where the team is spread across different sites or territories (more on global tax management later). We have also seen numerous problems arise through lack of good team communication. A typical risk area is ensuring that knowledge of high level planning issues flows through the implementation and compliance process such that any transactions or planning are properly dealt with in the final tax returns. Compliance work itself generates little additional value. Value is added mainly through having a good understanding of the impact of tax on the business and through planning work. However if this is not supported in the tax compliance work then the value can be lost or destroyed (see *Diagram 14*).

### Use of technology

New technologies offer excellent channels for communicating with the tax function's 'customers' and information suppliers, but can also make it easy to slip into less effective communications practices. Simply sending notes out through the 'e-mail blizzard' is fast and easy, but probably not a good way to build the tax function's profile in most organisations.

Diagram 14



When used effectively, intranets or communications databases can be powerful tools. Prior to the advent of the web and/or communications databases, tax manuals, policy documents, guidance notes etc. would often be sent out to the business, where they would be briefly looked at, filed on the shelf (or in one case used as a doorstop) and then soon lost or forgotten. Even worse than this is when business users may act on out of date guidance, resulting in sub-optimal or even illegal consequences. Using an intranet to keep such material 'live', up-to-date, visible and at the fingertips of anyone who needs it can be very effective. Our preference is to keep such facilities simple and brief, otherwise the cost of keeping them up to date can easily spiral. If this is not done, parts of the site risk falling into disuse.

### Does the cost structure encourage good communication?

Opinions vary on how best (or even whether) to charge businesses for the services of the tax function. Some people believe recharging should reflect the demands various parts of the business put on the tax function. Others believe that a fixed (or nil) costs structure is more appropriate as 'pay for use' charging can discourage businesses from involving the tax function. This can lead to sub-optimal performance for the business as a whole. There are also arguments for a hybrid charging structure where a usage charge is made for compliance work, but planning and consultancy work is provided at no additional fee, though this no doubt creates disputes about where the boundaries lie.

## Summary

Whatever other methods of communication are used, 'face to face' contact will nearly always make the key difference to a department's relationship with its 'customers' and information providers. Our experience is that the more effective tax teams really do spend a good deal of their time out of their offices.

Finally, we would recommend asking the businesses and other contacts how well you are communicating (and indeed working) with them. As an example, we worked with one tax function who told us they believed their communication with their businesses was good. We then found business units that did not know that the in-house tax department existed and had even approached the tax authorities for tax advice! Communication is a big issue which tax functions can not afford to ignore.





# 10

## Managing the tax team

Like any other business function, the tax function will not be able to devote 100% of its resources to serving its 'customers', and for a tax function to run effectively, some time and resource will need to be devoted to management of the tax function itself. Some of the activities under this heading are discussed below.

### Ensuring appropriate focus

The activities of the tax function should be driven by the tax strategy, but ensuring that individuals stay 'on-strategy' normally takes some effort. People will naturally gravitate to work they like, work they feel they will be rewarded for and work they are being pressured by 'customers' to deliver. This will not necessarily be the same work that will add most value to the business through effective implementation of the strategy.

Therefore, the tax director will normally need to monitor how the tax function is using its resources and ensure that the strategy continues to be followed. Care will also be needed to ensure that team and individual objectives and workplans continue to support the strategy and do not degenerate into task lists of routine or urgent tasks. We are aware of a number of tax functions where, as the deadline looms for filing tax returns, everything else is put on the back burner – irrespective of where it fits into the overall tax strategy.

Individual job descriptions and formal staff evaluation systems are a useful discipline in keeping individuals focused on the overall tax strategy. We are aware of feedback from the tax function's customers being used in this process. However, at the end of the day, people will do what they believe they are being measured on – and it is much more difficult to measure added value than whether all the tax returns have been submitted on time. Too often we see people focusing on those activities which are easy to measure – such as compliance matters.

One finance director told us he was seeking a head of tax who “didn’t know too much about tax” – admittedly a slightly ‘tongue-in-cheek’ comment, but he did want a tax manager who would focus on managing the impact of tax on the business, rather than become drawn in to technical research and computational work.

### The right skill sets

Tax functions have come a long way from the days when only tax technical skills were considered important. For most tax functions, strong technical skills will constitute a basic requirement, but other ‘softer’ business skills will prove crucial if the tax function is to be effective in actually managing the tax charge and risks. Indeed if a tax function sources its technical input from external advisers, it may not even be necessary to foster in-house technical expertise. Even when dealing with tax authorities, tax technical skills are probably less important than negotiating ability. Typical ‘soft’ skills that are much in evidence in more effective tax functions are illustrated in *Diagram 15*.

The task for the head of tax is to ensure they have the right mix and balance of these skills in the department. They will need to work to ensure that existing staff possess (or develop) and use these skills, or that people are recruited into the tax function to bring in the skills required. Training of these softer skills for in-house tax departments is, in our experience, seldom given the importance we believe it deserves. Indeed our experience is that training is often fairly ad hoc; best practice would dictate that formal training plans are developed annually for each member of the tax department.

One particular comment we have heard from a number of CFOs is that tax people can sometimes seem to need too much base information before a decision can be made. Tax is of course an area where one cannot divorce planning from the underlying base data, but given that decisions increasingly have to be made quickly on the basis of imperfect/incomplete data, the ability to work in such circumstances is likely to become a prized asset.

Diagram 15



## The one-person tax function

For those medium sized businesses that decide to have a tax department, but one that is to consist of just a single individual, a further decision will normally need to be made as to whether the individual should have high level 'head of tax' skills or should be more suited to detailed compliance and tax accounting work. It is rare that a single individual will be suited to both. Clearly this will also need to be reflected in the allocation of work between the in-house tax individual and external advisers and service providers. In our experience the more successful model for one person in-house tax functions is where the person has the higher-level skill base.

There are of course also some large businesses that also have one-person tax functions due to the business having outsourced nearly all of its tax management activities. Here the head of tax will normally need to be a high-level individual who will effectively manage the relationship between the outsourcing service providers and the business and ensure the tax strategy is being followed.

## Career issues

Particularly in a smaller tax function, ensuring team members have a career path open to them can be a serious issue. Most heads of tax are keen to ensure they retain the staff they have so that experience and continuity is preserved. However retaining long serving staff can present three particular problems.

- Staff become overqualified for the roles they hold. Most staff will look for periodic promotion and salary increases. Where such staff also have to spend some of their time on (for example) compliance work,

this can lead to them being overqualified and overpaid for the work that they do.

- Staff can start to go stale if the work they do lacks development opportunity.
- A resistance to change can arise. If staff do not have the chance to change their roles and develop it is very easy for inertia to set in and for work to continue much in the way it always has. Of course, this can sometimes be an advantage, but given the rate of change that most businesses (and indeed their tax functions) are currently experiencing, we believe that flexibility and ability to change are important advantages for tax teams.

For these reasons, some heads of tax we know actively encourage a reasonable degree of staff 'churn' in order to keep the tax function fresh. This is often the case for more junior tax staff, typically those who have joined the company shortly after qualification. Such staff, in conjunction with their heads of tax, are often quite open about the fact that they only intend to stay with the company for a couple of years in order to build up their experience and then move up the career ladder elsewhere.

In larger tax departments, where providing career progression is rather easier, it is beneficial to identify those members of staff that are the 'stars' and discuss a career path with them. These are often the staff that the business can least afford to lose and not providing them with a chance to progress is the surest way to lose them. If career progression is not possible inside the tax function, then a well-trodden route for tax people is into the treasury department – and having ex-tax people in other parts of the business is very

beneficial in ensuring the importance of tax is recognised elsewhere in the business.

## Work-life balance and fun

The late 1990s and early 21st Century have seen an increasing focus on 'quality of life' issues and on the business benefits of improving people's working lives. We believe that a team will perform more effectively if it is happy and the team members are content with their working life and therefore 'keeping it fun' is important. Many leading companies are starting to pay serious attention to such issues and tax functions need to ensure that they reflect this.

## Summary

The key asset of a tax function is its people. Having the right people doing the right things will be crucial to the success of the tax function. Keeping them focused and motivated is hence a key part of the role of the head of tax.



# 11

## Use of technology

In the early days of tax technology, there were some who predicted that by the year 2000 all tax planning would be done by complex computer systems, eliminating the need for the poor old human tax professional. Over the past 20 years we have moved well beyond the first primitive spreadsheets and technology now provides us with the potential to radically change how we approach both tax compliance and tax consulting. Despite this, and fortunately for those of us who earn our living in the tax profession, there is little sign of this particular vision coming to reality.

Today, as with all other areas of business, the tax function's use of computers has moved well beyond pure computational work and the most common areas of use are knowledge management, communication and collaboration. Typically, depending on the specifics of the tax function, technology might be used for:

### Knowledge management and group working

- Electronic text books and knowledge sources
- Sharing and/or dissemination of information
- Document storage and document management (the paperless office does exist!)
- Allowing groups (and their advisers) to work together from different locations through shared databases and 'e-workrooms'
- Managing global tax issues and projects through a shared global database

### Planning and compliance

- Preparation of tax computations, returns and tax accounting calculations
- Compliance data gathering, not least automated extraction of data from accounting systems
- 'What if?' modelling and calculations
- Data mining, particularly in the context of tax auditing of accounting data
- Monitoring of time limits and other diary events

### Communication

- Sending and receiving e-mail, voicemail, instant messaging etc
- Electronic meetings, presentations, conferences and training
- Document production and desktop publishing

### Control/administration

- Project and task management
- Controlling workflow
- Personal diaries, address books, to do lists etc

... and all that without even having mentioned the Internet!

In other words, there are now almost endless uses for technology in the tax function. However the question should not be “What can we do with technology?” but rather “How can we use technology effectively?” We have each seen many occasions where someone has created a spreadsheet, database or some other IT tool to perform a task and a year later it is out of date or unused. Technology can be very powerful, but the costs and risks of buying/building a solution and then maintaining and developing it thereafter often prove much greater than was ever originally envisaged.

Sometimes people seem to think that IT is part of the core business of the tax function – it is not; tax functions are about managing tax charges and tax risks, and IT tools are just a solution to help them do so.

We would add a particular word of caution on automated compliance data gathering. The potential benefits of automating tax return production are clearly substantial. Set-up costs can, of course, be significant, but often the real costs/risks are in maintaining a heavily automated solution, not least as accounting systems and accounts coding structures change. This is not to say that companies are not yielding great benefits from tax automation; many are. However, our experience is that the real winners are those who implement carefully targeted IT solutions, rather than those who try and automate everything in sight.

Where a potentially cost effective technology opportunity is identified, the next question should be whether the solution should be owned and maintained in-house or whether it would be more effective to ‘rent’ a solution from a service provider and

leave them with the costs and risks of development and maintenance. It would also be a lot easier to benefit from economies of scale through leveraging a service provider’s technology than through use of a bespoke in-house solution. To quote an advertiser’s phrase, “You don’t need to buy a cow just because you want a glass of milk!”

We hope that our comments here are not mistaken. We are not suggesting that we are ‘lukewarm’ about tax technology. On the contrary, we have seen huge benefits brought about through use of technology, but we have learned that it is important to recognise the full costs and risks of technology as well as the potential benefits. Only the largest organisations with the greatest economies of scale are likely to benefit from going it alone.

Full automation requires that systems should anticipate every potential situation and as a result many technology projects have failed to meet expectations or have taken far longer to realise benefits than originally envisaged, because of unforeseen levels of complexity. We have also met several tax managers who have carefully thought through how to institute technology driven process improvements and moreover have the skills to achieve what they set out to do by themselves, but who, one/two years later, have failed to achieve what they set out to do because, inevitably, other issues have intervened and taken priority.

## Current ‘best practice’

Rather than just highlight specific success stories, we would suggest five ‘cultural’ indicators typically observed in tax functions that are making effective use of technology.

- The tax function is recognised as a co-owner of (or at least significant stakeholder in) the accounting system. Rather than extract accounting data and then manipulate it into a ‘tax ready’ form, the tax function will have helped design and modify accounting structures so that much of this work is done by the accounting system itself.
- Any remaining extraction and processing of compliance data is highly automated, with a particular focus on ‘the difficult bits’ that traditionally account for significant proportions of the tax team’s time.
- Documents and reference material are stored and accessed electronically.
- Status and progress reporting is highly automated. When tax function management needs to clarify the status of work or issues, they do so by viewing real time progress information, not by having staff compile monthly progress reports manually.
- The tax function lives the ‘now culture’ of the Internet world, with research (even for simple tasks, like checking a train timetable) instinctively done on-line, material being retrievable instantly on-screen rather than requiring a secretary or a junior to trace the document concerned, and information being obtained and delivered in ‘real time’ as needed.

The question should not be “What can we do with technology?” but rather “How can we use technology effectively?”

## Future growth areas

If the first paragraph of this section did not make it clear, making predictions about future technology almost guarantees that one will subsequently be proved wrong. With that caveat, here are six areas which at the time of writing, are starting to show early promise.

- The use of financial reporting mark-up languages (such as XBRL – a standard backed by the accountancy profession and major technology companies) has the potential to simplify and standardise the extraction of financial information required for tax purposes. More broadly, the rapid adoption of this and other XML-based standards is generally making the movement of information around and between organisations far easier.
- Automated workflow – a concept which has existed for quite some time, but which is now yielding real benefits, both in terms of efficiency and in reduced risk.
- Tax data warehouses, where one single set of tax data is maintained in a central location, irrespective of who is analysing, processing or auditing it, seem to offer significant advantages over the traditional approach of extracting data separately each time when needed for any particular purpose. Traditionally such data has been used mainly for post-event tax compliance purposes. However when combined with the right tools, such an approach now makes it easier to ‘cut and slice’ data needed for managing the future tax charge, all within a short timescale. The data warehouse approach also sits comfortably with the growing use of ‘data mining’ tools (for example automated searches of expense

narratives to detect occurrences of ‘tax sensitive’ words and phrases).

- ‘Collaborative e-space’ or ‘e-workrooms’ allowing teams, whether in a single organisation or across multiple organisations, to work together over the web.
- The sourcing of technical advice and ideas on-line is growing at a rapid rate. There are potentially significant cost savings and quality improvements here for both buyers and sellers of advice, and we therefore expect this to be a significant growth area.
- A little further in the future, emerging Internet standards will lead to growth in an area that is currently being termed ‘web services’. In effect, you will be able to create relatively complex systems by ‘renting’ individual services from particular suppliers, perhaps a calculator from one and a review tool from another, and joining them together using the Internet.

## Summary

Technology offers great opportunities for tax functions to work more effectively. It also offers similar opportunities for tax authorities. It is becoming an increasingly connected world and the possibilities offered by technology will continue to grow. Clearly tax functions need to keep IT issues high on the agenda. However care also needs to be taken when planning technology solutions to ensure the costs and risks are properly managed.



# Use of external advisers and service providers

Our experience of large companies' approaches to the use of external advisers and service providers spans the whole spectrum from those who consider advisers to be an over-priced resource, to be used only in the last resort, to those whose only in-house tax resource is a single in-house tax manager whose role is to operate primarily as a buyer and controller of external inputs. Clearly as a partner and senior manager in PricewaterhouseCoopers we must declare an interest in how businesses use external tax advisers, but we hope our thoughts and observations below remain balanced and objective.

## In-house or external resource? Some key pointers

If we assume that most tax functions will choose to keep some work in-house and to contract/outsource some work to external advisers and service providers, *Diagram 16* might provide useful pointers as to what work is best allocated to whom.

Diagram 16

Typical in-house tax function strengths	Typical external adviser/service provider strengths
<ul style="list-style-type: none"> <li>• Ability to manage relationships with the business</li> <li>• Implementation and project management skills</li> <li>• Knowledge of in-house systems, processes and controls</li> <li>• Knowledge of the business</li> </ul>	<ul style="list-style-type: none"> <li>• Depth of specialism and knowledge</li> <li>• Access to ideas</li> <li>• Knowledge resources</li> <li>• Investment in processes and technology</li> <li>• Multi-territory coverage and co-ordination</li> </ul>

## Why use external advisers or service providers?

Tax work is almost never going to be 'core business' for a company, whereas it is exactly that for a tax adviser or service provider. On the back of this, the reasons we hear for using advisers/service providers include:

- to access ideas, skills, knowledge, specialist experience, processes or technology – where the external adviser can add value which is not available in-house;
- to avoid having to make the investment in such areas;
- to provide 'on-tap' resource which can be turned on and off at will;
- to compensate for lack of resource in-house – and in particular to manage peaks and troughs;
- to reduce cost (and sometimes headcount) by benefiting from advisers' efficiencies and/or economies of scale, particularly in the area of compliance;

- to 'skills match' using staff with a level of experience (whether more junior or senior) not available in-house;
- to gain a 'second opinion';
- to gain the benefit of an external perspective from someone who deals with a large number of other companies; or
- to reduce and/or externalise risk.

However where external advisers are being used they need to work closely in partnership with the internal tax department. They need to understand the tax strategy of the business and how they fit into this. Regular review and feedback of their activities is important to the successful working of this partnership.

## Common concerns

We encounter a number of reasons why work should be kept in-house rather than dealt with by an external adviser. However by sharing these concerns up front with the professional adviser a solution can usually be found which is acceptable to all parties. These concerns include:

- new experience which would otherwise be gained in-house is lost;
- time may be required to manage the advisers and/or to translate their opinions into more meaningful action points;
- some advisers' aversion to risk may lead to over-caveated or over-cautious opinions;
- advisers can be (or can be perceived as) weak at implementation of planning and ideas;
- 'asking for help' may be perceived as a sign of weakness; or
- cost.

The key to working with advisers is clear terms of reference, good communication and, as we have heard many times, no surprises.

## The trend

Tax advice and provision of tax services is a growth market. (This was a clear theme to emerge from the tax function research work we have carried out in association with Cranfield School of Management.) We believe there are four main reasons for this.

- Partly due to increased fiscal complexity and increasingly complex (global) business operations, and partly due to an increasing recognition of tax as a manageable cost, the demand for tax advice is increasing.
- Increased fiscal complexity is leading to demand for deeper, narrower technical specialism and experience which can only be provided by companies that are large enough to support such specialists and/or have made the appropriate investment.
- Companies are increasingly focusing in-house resource on core business activities, and indeed reflecting this in headcount reduction exercises. Activities that are non-core are frequently outsourced.
- In certain areas, external advisers and service providers are offering improved value for money.

We see no foreseeable reversal in any of these drivers and therefore we expect that in-house tax functions' use of external advisers will continue to grow.

## Outsourcing

Companies have always farmed out tax work to external advisers, but normally on a relatively short-term basis as and when required. However in recent years more formal outsourcing arrangements have started to be put in place. As with other business process outsourcing arrangements, this normally involves multi-year contracts, agreed service levels, contractual commitment to process improvement and (often) fixed fees.

There has been particularly notable growth in outsourcing of tax return processing work, as advisers' investment in process and technology has made it much more cost-effective to outsource this work than was the case in the past. However we have seen some groups go considerably further than just compliance outsourcing, in some cases outsourcing the whole tax function – usually leaving a one person tax function whose role is to act as a co-ordination and liaison person between the group and the service provider.





## “WYMIWYG – What You Measure Is What You Get”

It is a long established management doctrine that measures and targets influence performance. Whilst the position is beginning to change, our experience is that relatively few tax functions have formal targets or metrics – and where they do, they often revolve around the things which, as noted earlier, are both easily measurable and are relatively easy to achieve, such as submitting all the returns by the statutory filing date.

The challenge, we believe, is to have performance metrics which tie in with the overall tax strategy and that KPIs (key performance indicators) used by the tax function reflect key strategic goals. Only when this is happening will the tax function genuinely be able to show the value they are adding to the business – and be in a position to justify better the extra resources many functions say they need.

As this is a difficult area, some tax functions have argued that time spent measuring performance is time that could otherwise be spent managing performance. We do not agree. Provided the right measures can be found, movements in the measures will reflect the impact the tax function is having on performance, and measuring is therefore a key management discipline. The key question is therefore “what are the right measures for a tax function?”

### What should/could a tax function be measuring?

In our opinion the KPIs for the tax function should be the starting point. If these are properly spelt out in the strategy discussions then they provide a framework for measuring the success of the tax function. However the KPIs are normally at a fairly high level and it is necessary to take these down to specific measurable objectives for the whole function and hence down to specific actions at the individual level. We accept that tax is a complex subject and building a model that serves as an effective measure of performance, in the face of a wide range of circumstances and influences, will be no simple task.

Some examples of the measures we do see in use in tax functions might be helpful. These include:

- effective tax rate based assessment;
- analysis of the structural/natural rate analysis (essentially the long term tax rates which would be expected to apply, eliminating short term fluctuations);
- competitor comparison – looking at the tax rate of direct competitors;
- ‘customer’ satisfaction is seen as important, and although we encounter relatively little formal measurement of this, we have seen some plans to survey the tax function’s customers; and
- tax return production or compliance deadline measures, though these often create a real risk of focus on deadlines rather than quality and often divert attention from higher value-adding work.

We have already commented on the importance of the cash tax rate in determining shareholder value and we expect that there will be an increasing focus on cash tax rates at the expense of the effective rate in the accounts.

Some groups are also looking at 'Balanced Scorecard' metrics for the tax function (see 'The Balanced Scorecard' – Robert S Kaplan and David P Norton). Two key themes we would briefly highlight here are:

- that a balanced scorecard needs to balance financial measures with non-financial measures. As well as the more traditional measures relating to financial performance and internal processes, there needs to be a focus on both 'customers' and 'learning and growth', in effect taking into account likely impact on future financial performance. Some illustrations of how this may be reflected in tax function measures are included opposite; and
- that as well as including 'lagging' outcome measures that reflect past performance, scorecards should focus on 'leading' performance drivers which will influence future results.

## Do tax functions really need formal performance metrics?

Certainly tax functions should measure performance against objectives and report on progress against strategy. However we believe the jury is still out in the case for numerical performance measures. We know of relatively few tax functions that currently operate formal measurement processes for the function as a whole. What often proves useful however is the discussion that surrounds the possibility of using measures, as this often throws up issues and challenges. It may not be clear whether a formal system of metrics will be right for a tax function, but we believe the debate should at least take place on a regular basis.

## The case for tax metrics

- Measures help focus performance.
- Measures help demonstrate value added.

## The case against

- Tax management is a very complex subject, not easily represented by numerical models.
- Tax charge, risk and management costs are subject to a number of uncontrollable external influences (in particular, changes in statute and precedent).

## Balanced scorecarding best practices for tax

For the customer perspective:

- consult tax function customers (as a part of strategy setting);
- establish service level agreements, and monitor performance;
- conduct customer satisfaction surveys; and
- measure tax resource allocation against customer requirements.

For 'learning and growth':

- attach importance to communication and knowledge sharing (especially outside normal contacts);
- measure staff 'feelgood factor';
- address information system capabilities; and
- ensure staff development objectives are on the scorecard.



“However beautiful the strategy, you should occasionally look at the results.” Winston Churchill





# Effective global tax management

Managing the global tax position of a group of companies can be very hard work indeed. Where a group has operations in more than a handful of territories, gathering information and exercising control typically results in a whirlwind of emails, phone calls and indeed visits to local business, finance functions, in-house tax teams and various external advisers.

Complicate this by involving different fiscal regimes, languages, time zones and business cultures and the result can be a management nightmare. Simply tracking who the various contacts are in each territory can be an uphill struggle.

As well as being a potentially major drain on head office tax resource this scenario often means that the global tax charge and risks are not managed as effectively as they could be. Even where a group does have a basic degree of control over the global tax position, most heads of tax we know are forced to focus only on the largest transactions and profit flows and on the major trading territories. They simply do not have the resource to 'dig deeper', even though there could be significant untapped opportunities or uncontrolled risk elsewhere.

## What needs to be managed?

Once again, this will depend on the group's tax strategy and key tax drivers, but examples of issues and information which groups seek to control are shown in *Diagram 17*.

Diagram 17

<p><b>Strategy and planning</b></p> <p>(albeit some of this information will also be required for compliance purposes)</p>	<ul style="list-style-type: none"> <li>• Dissemination of group tax strategy, policy, procedures and responsibilities</li> <li>• Transfer pricing information and policy</li> <li>• Dividend, interest and royalty flows</li> <li>• Other key 'value flows' (activity mapping), holding and financing structures</li> <li>• Withholding taxes and tax credits</li> <li>• Underlying local territory tax rates</li> <li>• Tax losses and other local tax assets</li> <li>• Other international structuring issues</li> <li>• Key transactions with potential taxation implications</li> <li>• Financial information having tax implications</li> <li>• Planning ideas and activity (both to monitor activity and to encourage it to take place)</li> </ul>
<p><b>Compliance and reporting</b></p>	<ul style="list-style-type: none"> <li>• Tax reporting requirements and timetables</li> <li>• Information required for head office tax accounting</li> <li>• Information for head office territory compliance purposes</li> <li>• Tax enquiries, audits and risk issues</li> </ul>
<p><b>Administration</b></p>	<ul style="list-style-type: none"> <li>• Details of local contacts (in-house and external, tax and non-tax)</li> <li>• Details of local entities, branches and permanent establishments</li> <li>• Local tax histories</li> <li>• Resourcing, costs, fees and use of advisers</li> </ul>

There are no doubt other items that are missing from the above list. However as well as ensuring that key items are tracked and managed, groups will also need to ensure that they are not devoting resource to tracking items where the potential benefits do not justify the costs of doing so. The tax function needs to sort out the wood from the trees so it can focus on what really matters.

## Basic discipline

Easing the gathering of the above information requires investment in scoping out responsibilities and ensuring all concerned take them seriously. If contacts are given clear guidance as to the information required, the format in which it is supplied, the timetable for provision and the reasons why the information is needed, they are more likely to provide what is needed without further chasing.

In large organisations, this discipline will need to be continually reinforced as the group structure and the tax function's contacts change. Inevitably not all information needed will be provided to timetable, but if the requirements and timetable are properly defined and documented then a junior (administrative) member of staff can be charged with following up missing information, rather than having to have experienced tax staff spend time chasing it up.

## Use of technology

Database and web technology lends itself very well to managing information across disparate locations. A good technology tool will help communicate what information is required (and when), standardise information formats, provide the repository for storing and sharing information and (potentially) highlight and/or chase for missing information.

One caution – our experience is that provision of a good technology tool is unlikely to bring about any significant improvement in itself. It will only deliver results if the discipline surrounding its use can be instilled/enforced. It is the information content that ultimately matters, not the technology that is used to manage it.

## Use of external service providers

We are suggesting that to improve the effectiveness of global tax management it is necessary to instill the appropriate discipline into one's team in other territories. This investment does not necessarily need to be made in-house.

An outsourcing service provider will probably already have put similar solutions in place for other clients and will be used to liaising with local territory contacts to ensure the right information is gathered at the appropriate time. Why not leverage off a service provider's investment in people, processes and technology rather than try and secure internal investment in something which is non-core to that business? There may also be economies of scale and commercial advantage in negotiating a central agreement with a single service provider rather than engaging a miscellany of local advisers. Service providers will also have 'critical mass' in territories where group operations may be too small to merit in-house tax resource.

## Going wider than tax

Whilst we are speaking here about global tax management, other departments may be facing similar investment and outsourcing decisions (for example regarding company secretarial work, treasury work, legal affairs etc). It may therefore be worth

considering some joint investment or outsourcing approach in conjunction with these other functions.

## Summary

The increasingly global economy means that managing the global tax position is taking on greater importance for group tax directors. Planning around structures, financing and different business models are all vitally important. However without proper information and communication it will be very difficult both to make the right decisions and to ensure that these decisions are being implemented and monitored.





## In conclusion

Tax functions are operating in a rapidly changing world. The last few years have seen significant increases in the demands of and pressures on the tax function and as a result we are witnessing significant changes in the nature of in-house tax departments. Old style 'back room', compliance focused departments are in decline, with a clear trend towards higher profile 'value-driven' tax functions.

In our opinion the winning tax function of the future will:

- lead, not react;
- pursue a clear strategy;
- 'genetically engineer' their own flexibility; and
- sit at top table.

This increased pressure is of course not all bad news. It may be a tougher world with higher stakes, but those who can play at a higher level have the potential for better careers and greater reward. Enjoy the challenge!

Finally, we hope you will have found useful, thought-provoking material in this guide. The content is of course based on our own observations, views and experiences. We are keen to hear yours and would very much welcome any observations you would care to make.

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# Appendix I

## Tax function best practice

### A quick 'though provoker'

Company name

For each question below, select the answer you believe is closest to your current position.

	A	B	C	D
Is your senior management (the Board?) aware of key tax issues, risks and opportunities?	<input type="checkbox"/> Largely not – Senior management shows little interest in tax issues (other than if major problems arise)	<input type="checkbox"/> Partly – Key tax issues are discussed with senior management at (for example) audit clearance time	<input type="checkbox"/> Yes – Key members of senior management are regularly briefed on tax issues	<input type="checkbox"/> Yes – Senior management is well aware of (world-wide) key tax drivers in the group, and actively encourage business staff to manage them
Do you have a tax strategy?	<input type="checkbox"/> No	<input type="checkbox"/> Yes – Strategy discussed within the tax department, though not recorded in writing	<input type="checkbox"/> Yes – Written and circulated within the tax department	<input type="checkbox"/> Yes – Written, agreed with the board, periodically reviewed and communicated outside the tax department
Are tax issues addressed when business decisions are made?	<input type="checkbox"/> Often not – There is an obvious need for improved tax/business liaison	<input type="checkbox"/> Normally – Though there are sometimes instances of tax being left 'out of the loop'	<input type="checkbox"/> Yes – Tax is always alerted to 'big ticket' transactions, and has some contact with business managers on day to day issues	<input type="checkbox"/> Always – There is a strong 'tax culture', with tax well informed of business developments, and vice-versa
Do tax or accounting staff spend significant amounts of time in gathering and analysing information for tax compliance purposes?	<input type="checkbox"/> Yes – Data gathering is wholly manual	<input type="checkbox"/> Yes – Though some very basic automated data gathering is used	<input type="checkbox"/> Yes – Though some automated data gathering is used, and more is planned	<input type="checkbox"/> No – Data gathering is highly automated
Do you believe that your tax function's development objectives reflect the needs of a leading tax function?	<input type="checkbox"/> No – Tax function objectives are either not set, or are task focused	<input type="checkbox"/> To a degree – However tax objectives still focus primarily on technical issues and on compliance objectives	<input type="checkbox"/> Yes – Objectives recognise provision of effective tax support to the business as key role.	<input type="checkbox"/> Yes – 'Higher' skills such as management, communication and change skills are seen as key in development plans. Compliance/ technical skills are seen as a basic competence

Any ticks other than in column D suggest potential for improving effectiveness of tax management.

## Appendix II

# Tax function activity analysis - guidance notes

The table on page 69 is designed as an aid to help in-house tax functions, or individual tax function staff, who are analysing how they might make more effective use of their time and focus more time and resource on higher value adding activity.

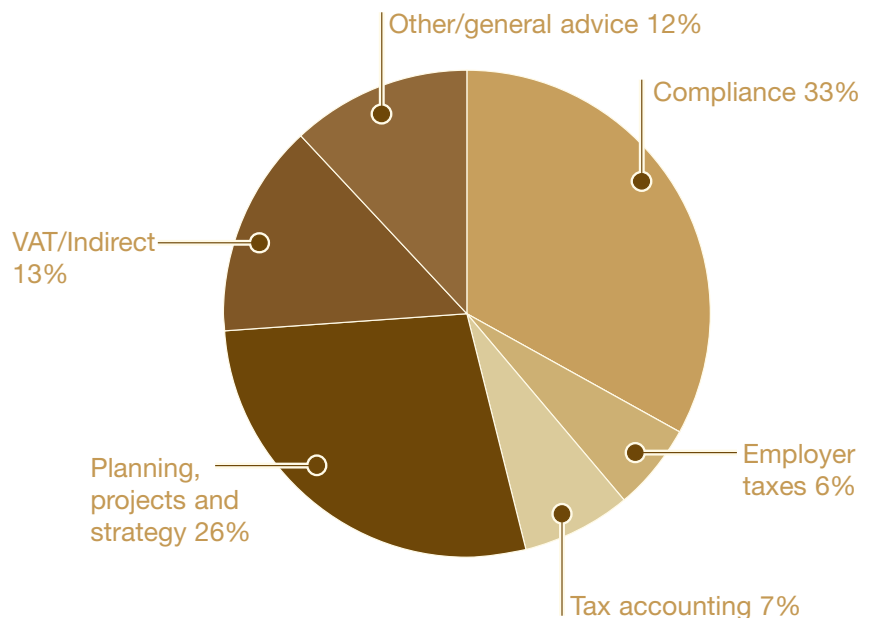
The table highlights four key areas of a tax function's role, from high value tax strategy/leadership work, through business support, to compliance work, with tax team management being included as an important element of most tax functions' activity. For each level of work, various examples of typical activities are included. You may also need to add other types of activity.

The table assumes that the tax function will be trying to refocus resource from low value, compliance and 'scorekeeping' activities, to higher value adding activities that have a positive impact on the group tax charge and risk. Broadly speaking, higher value activities are nearer the top of the page, lower value activities toward the bottom with tax team management being an exception to this, in that good team management is likely to be a 'foundation' to achieving effective tax management.

To contrast the current and future scenarios, use the left hand column to analyse estimated amounts of time currently spent on various activities and then the right hand column to set out the time as you would wish it to be in the future. The units of time are unimportant; hours, man-days or percentage split can all be used. Equally, whether or not 'non-productive' time (such as holidays, sickness etc) is included is unimportant, provided a common basis is used for any group of individuals analysing their time.

As a benchmark, the 1996 tax survey carried out by Cranfield School of Management on behalf of PricewaterhouseCoopers<sup>1</sup> indicated the following average time allocation for UK FTSE 250 (respondent) companies (see *Diagram 18*).

Diagram 18



NB.

- The survey was undertaken in 1996. Anecdotal evidence suggests that most tax functions have since increased their focus on value added activity, such as planning, projects and strategy work. Advances in tax technology and compliance outsourcing are also expected to have reduced the proportion of compliance time.
- The survey was a snapshot of the 'actual' position at that time, not the desirable position.

<sup>1</sup> 'Benchmarking Tax for Profit' – 1996 – PricewaterhouseCoopers in conjunction with Dr Brenda Porter and Cranfield School of Management. For further research on the role of the in-house tax function, see also 'Tax Function 2000 – Meeting the compliance demands of the future' and 'Tax Function 2001 – Supporting the strategic and business demands of the future' (PricewaterhouseCoopers in conjunction with Dr Brenda Porter and Cranfield School of Management).

Tax function activity analysis – time analysis				
	Time spent now	Activity	Examples	Target time allocation
Strategy/leadership		Group tax strategy	Setting and reviewing tax strategy. Briefing business leadership. Directing tax strategy across the group. Understanding key tax drivers. Setting/reviewing objectives and plans to ensure implementation of strategy. Managing tax communication with the Board.	
		'Blue sky thinking'	Creative 'what if' thinking. Brainstorming sessions. Away days. Challenge meetings with external advisors.	
		Political/industry bodies	Industry and professional groups and conferences. External networking. Lobbying of governmental bodies.	
		Major tax driven business re-organisation	Aligning global business strategy, operational structure and corporate structure with tax and financial strategy etc.	
Business support		Tax aware culture/group tax communication	'Face time' with key business contacts (including CEO, CFO, business managers, legal, tax, domestic and overseas). Attending key meetings/conferences. Producing guidelines, business briefing material. Input to newsletters. Maintenance of tax intranet site.	
		Tax technical and transaction advice	Merger, acquisition and divestment work. Project support. Assisting business with tax sensitive transactions.	
		Tax scheme evaluation and implementation	Reviewing tax planning suggestions from external advisors. Implementation, monitoring and ongoing review of planning ideas. Post implementation evaluation.	
		Other tax planning work	Proactive identification of planning opportunities. Ensuring planning ideas are actioned. Overseeing implementation. Monitoring progress and outcome of planning initiatives. Negotiation with tax authorities.	
		Tax resource management	Ensuring tax resources (internal and external) are aligned to business needs. Service quality meetings with businesses.	
		Tax data and knowledge management	Capture and sharing of ideas. Tracking history of tax issues.	
		Tax forecasting	Forecasting the ongoing impact of tax on the businesses. Provision of information for business reports and forecasts.	
Compliance		Tax risk management, controls and self-audit	Identifying tax risks. Mapping and devising controls and ensuring they remain appropriate and are likely to be viewed as adequate by the fiscal authorities. Testing the effectiveness of controls. Accounting systems work.	
		Group tax compliance management	Maintaining and controlling group tax payments, accounts, claims and elections etc.	
		Multi-territory tax control	Liaison with overseas businesses, tax functions and tax advisors. Monitoring global tax progress. Data gathering. Setting guidelines, procedures, protocols.	
		Liaison with tax authorities	Managing relationship with fiscal authorities. Dealing with tax audits and enquiries. Provision of information to support tax returns.	
		Entity tax compliance management	Planning, monitoring and carrying out compliance work (including review work).	
		Data collection	Planning data gathering processes and liaison with compliance data providers. Gathering and chasing data. Reviewing data quality. Dealing with deficiencies in data received.	
		Tax accounting	Year-end tax accounting work.	
		Routine business queries	Fielding straightforward tax queries (e.g. employee tax and indirect tax issues).	
Tax team management		Personal and staff development	Training and education time. Staff coaching. Performance and development reviews.	
		Team building	Team meetings. Team building events. Away-days etc.	
		Team planning, project management & evaluation	Team objectives and action plans. Evaluation against strategy, objectives and workplans.	
		Financial management/resource management	Financial management and planning, budgeting, financial reporting etc. Liaison with businesses regarding use of 'shadow' resource. Recruitment.	
		Management of advisers	Selecting advisers and service providers. Contractual and engagement work. Agreeing service levels. Monitoring performance. Periodic service quality meetings.	
Total time				

# Appendix III

## Tax strategy document: a sample framework

We are seeing an increasing realisation that a properly documented tax strategy is a must under corporate governance best practice. Additionally best practice demands that the Board, or at very least the Audit Committee, has agreed and signed off the tax strategy. Whilst there is no right answer as to what a tax strategy might look like, there are some areas that probably should be included in all written tax strategies.

The purpose of this appendix is to provide a sample framework for a company that wants to produce or document its tax strategy. It covers what we believe to be the key areas that should be included in a tax strategy document. The framework is equally applicable to companies that do not have an in-house tax function.

### Table of contents

#### I High level overview

- 1 The external environment
- 2 Total tax contribution
- 3 Attitude to tax planning and risk
- 4 Tax strategy template
- 5 What the Board are being asked to comment on

#### II Key areas of focus/risk

- 1 [Area of focus/risk 1]
  - What is the issue
  - Objective(s) for addressing the issue
  - Barriers to achieving the objectives – and how to overcome them
  - Action plan
- 2 [Area of focus/risk 2]
  - What is the issue
  - Objective(s) for addressing the issue
  - Barriers to achieving the objectives – and how to overcome them
  - Action plan
- 3 [Area of focus/risk 3]
  - What is the issue
  - Objective(s) for addressing the issue
  - Barriers to achieving the objectives – and how to overcome them
  - Action plan
- 4 [Area of focus/risk 4]
  - What is the issue
  - Objective(s) for addressing the issue
  - Barriers to achieving the objectives – and how to overcome them
  - Action plan
- 5 [Area of focus/risk 5]
  - What is the issue
  - Objective(s) for addressing the issue
  - Barriers to achieving the objectives – and how to overcome them
  - Action plan

### III Role of the tax function

- 1 Structure of the tax function
- 2 Role of 'shadow tax function'
- 3 Reporting lines
- 4 Using external advisors
- 5 Developing the team

### IV Stakeholder engagement and communication

- 1 Who are the stakeholders in tax?
- 2 The communication plan

### V Performance metrics – the balanced scorecard

### VI Summary

- 1 Overview
- 2 Matters for Board/Audit Committee approval

# Contacts

PricewaterhouseCoopers has a global network of tax management specialists. For details, contact:



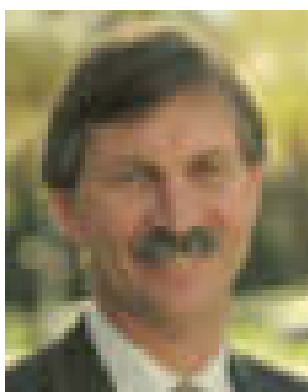
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