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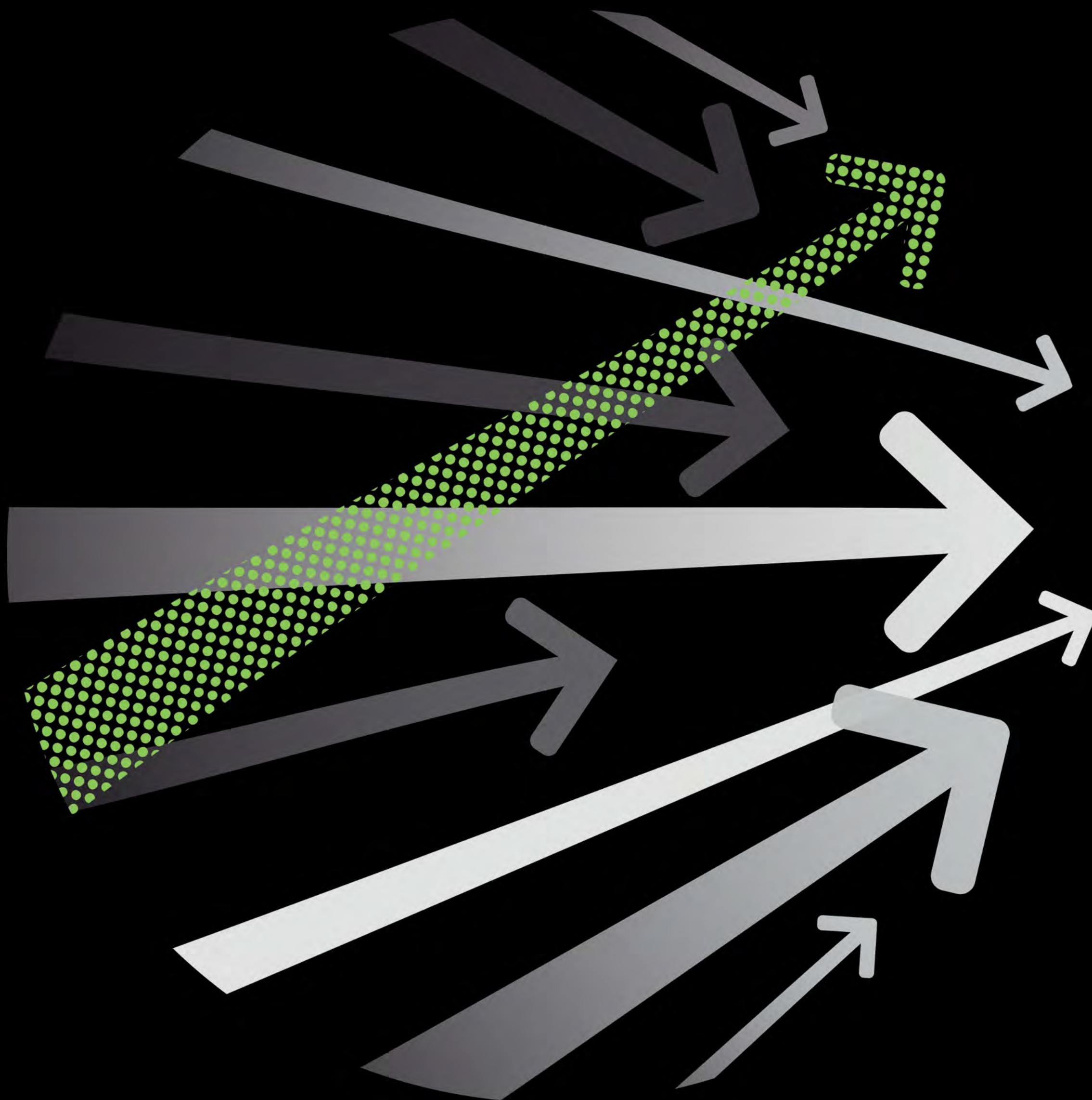


Creating the future, together

Tax compliance in a digital world

April 2019

Tax compliance and automation: Adapting to the digital era

In an era where amazing advances in technology seemingly emerge on a weekly, if not daily, basis, companies across the industry spectrum are reimagining the way they do business. Digital transformation is happening at many levels. For example, most enterprise resource planning (ERP) vendors are migrating their applications to the cloud, giving their customers the opportunity to consolidate and centralize instances of those applications and, importantly, the data that supports them. SAP, as one of the large ERP vendors, has announced that it will provide technical maintenance for its ECC and R/3 platforms only until 2025, which will prompt most SAP users to move to S/4HANA by 2026[1]. Business processes, such as loan applications and underwriting, are being digitized from end to end. Entire business models are being disrupted by emerging digital competitors, such as peer-to-peer lenders. S/4HANA and other in-memory technologies provide evidence of a massive paradigm shift for tax. While most tax departments currently work with backward-looking data to make decisions for the future, tax will need to develop the ability to make forward-looking decisions using online data feeds without major technical restrictions or limits.

Amidst these transformative changes, some back-office functions, such as finance, accounting, and human resources, are playing catch-up. Yet perhaps nowhere is the need to change greater than in tax. Virtually every decision or transaction in business has a tax implication, and regulation is not likely to get any simpler. Tax needs to address global data requests from the tax authorities, which want access to more data, sometimes with real-time data-feeds directly from a company's IT systems. To be relevant, tax must adapt quickly and align to the increasingly digital and automated enterprise. But, adopting new digital approaches can be disruptive.

This piece summarizes considerations and steps you can take to help mitigate the disruption for business model optimization and compliance.

Why there should be urgency in corporate tax departments:

Tax professionals traditionally have spent a significant amount of time on tax compliance obligations using hindsight data and information. Recent conversations with executives from multinationals revealed that tax compliance consumes approximately 54 percent of a tax department's time. The majority of interviewees said the proportion of time spent on compliance has increased compared to last year.

Specific factors driving the increase in time spent on compliance include:

- A lack of legal-entity-specific data in financial systems.
- The increasingly complex global tax environment, including changes in tax legislation influenced by Base Erosion and Profit Shifting (BEPS) guidance and the 15 actions issued by the OECD (Organization for Economic Cooperation and Development).
- Rising scrutiny from both the media and general public on multinationals and a perception that multinationals avoid paying "their fair share" of taxes.
- Heightened scrutiny and enforcement by tax authorities.
- Greater data granularity and more frequent data transmissions required by tax authorities in a growing number of jurisdictions
- Natural consequences of increased business activity, such as mergers, acquisitions, and expansion into new markets.
- The need to quickly get up to speed on new compliance policies and potential impacts.

In the past, companies often overcame these issues (especially poor-quality tax data) by assigning more people to address the problem. Yet with increasing globalization, changing business models, and evolving tax rules, such an approach is unsustainable. There is an increasing global trend (e.g., tax compliance management systems, cooperative compliance approaches, horizontal monitoring, etc.) requiring companies to document and disclose their tax processes, to invest in tax technology improvements, and to identify and proactively manage their tax risks by implementing reviewable tax controls to be eligible for less-stringent tax audits, filing-deadline extensions, or penalty reductions. As companies and their tax departments struggle to keep pace, the urgency of adopting new technologies to gain efficiency in tax compliance, reporting, and analysis grows. A mature tax organization imperatively requires more technology-driven automated processes, rather than more headcount. Investments into information technology and process standardization help achieve a stable and robust tax controls framework which allows companies to better protect senior management from tax investigations..

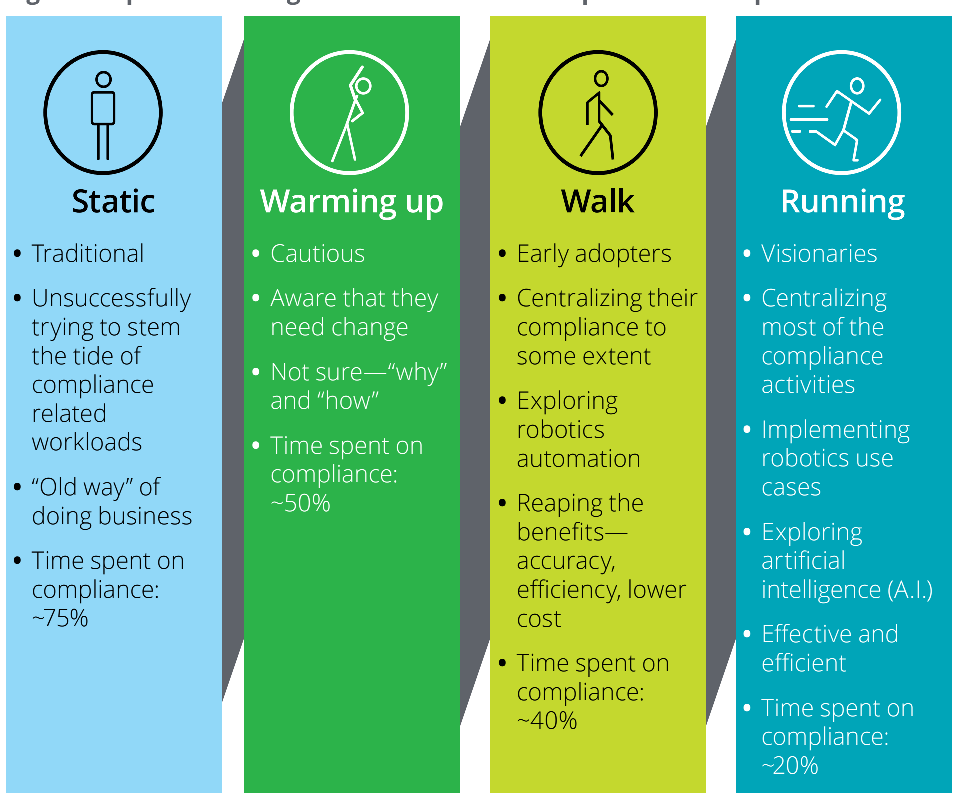
More people will not address the problem: Adopt new technologies to stay competitive.

Multinationals' response

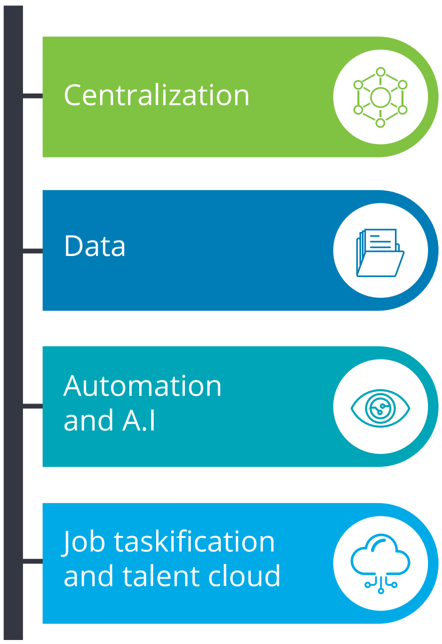
Given the dynamics of digital transformation and the converging forces of globalization, regulatory scrutiny and enforcement, and generational changes taking place in the workforce, many companies are seeking to reconfigure their tax compliance delivery model. Visionary organizations are reconfiguring the sourcing and technology aspects of the tax operations puzzle into a new operating model design. This includes redesigning their processes to create seamless handoffs between machines and humans with the goal of a digital record-to-report process. At the same time, these organizations are expanding their workforce to include resources outside the traditional tax department, such as finance and tax personnel in shared services centers and global business services organizations. By doing this, they are not just lifting out pieces of an existing process and automating it, they are reassessing who should do the work and viewing machines as part of their resource pool. Tax departments can typically be placed along a spectrum of willingness or ability to undertake digital transformation (Figure 1).

> Digital Transformation = Greater availability and affordability of technology:
> - Increasing interconnectedness
> - Integration of tax into ERP solutions

Figure 1. Spectrum of digital transformation adoption in tax departments



Transformation opportunities



Tax departments moving ahead with digital transformation should focus on the following key opportunities:

Centralization

Centralization, either in physical locations (shared service, global business services) or virtual centers of excellence (CoEs), will be critical for tax departments. Centralization enables the harmonization of tax compliance processes and protocols to help address tax risks, increase quality, enhance value, and lower costs. Harmonization, in turn, creates the opportunity for increased transparency globally, which can aid in addressing global effective tax rates, managing cash taxes (including tax refunds), supporting tax examinations, and developing transfer pricing documentation and reporting. A new driver for centralization is in-memory computing (e.g., S/4HANA), which allows companies – for the first time – to globally standardize data in an integrated global ERP system.

Data

Centralization requires a tax department to improve data governance, management, and quality. As a result, it is vitally important to assess and remediate gaps and quality issues in current data sources, as well as to build an effective data strategy going forward. The strategy should cover multiple ledgers, multiple systems, legal entity data, and retention policy. A business case should be built to show the return on investment in the strategy and how that aligns with broader enterprise goals. One important element of the strategy and business case is how high-quality data forms the foundation for real-time analytics that enable the tax department to be a more informative and active partner to the broader enterprise, as well as providing operational insights that can help reduce the costs of compliance and address tax compliance risks. Absent these elements, advancements in technology or business models are likely to sputter or fail entirely.

"The role changes; you become a gatekeeper for the work that's in the service centre. So, [the role becomes] review, rather than getting involved in the nitty-gritty. The scope of your role changes: before you were doing compliance, [but now] you can trust that's being dealt with and concentrate on other areas of the business, to add value there." Head of Direct Tax, Retail, Europe"

Multinational executives highlight a few common, arguably self-imposed, barriers to change:

- Inertia—not seeing any need for change
- A perception that the business and its tax department aren't an appropriate size or don't possess the sophistication to warrant digital transformation in the form of centralized tax databases, tax portals, and tax workflow tools
- Perceived complexity—the preparation required to scope and specify tasks

"If everything's automated, then people within the tax function, to add any value, [will need to be at] a higher technical level. There will be fewer roles for people who are there just mechanically going through the motions, repeating what they did last year to generate the necessary reports in terms of declarations. The profile of our tax department would have less people but probably be of higher caliber.

More management and communication skills [will be required], rather than technical. A tax person who's super technical, at home with legislation, can do clever stuff but can't interact and can't communicate... is no longer of use. We've got business software to do that." Tax Director, Manufacturing, Asia Pacific".

Machine learning: software's ability to improve performance by exposure to data without the need to follow programmed instruction code. Computer vision: software's ability to identify objects, scenes, and activities in images/forms.

Automation and A.I.

Based on its rules-based, data-driven processes, tax compliance is an area ripe for automation, analytics and, ultimately, artificial intelligence (AI). Data has the potential to reveal many insights that can lead to improvements in tax operations, planning, and reporting.

In recent discussions, the majority of executives indicated they believe full (or significantly more) automation of the tax function is a long way off. They may recognize the benefits of automation, such as long-term cost savings, but are pessimistic of the upfront investment, time commitment, and planning required. Accordingly, many tax departments begin with a pragmatic approach to their automation journey. In most tax departments, the prevailing form of "tax technology" is a collection of self-developed, non-monitored spreadsheets. Experienced tax experts have come to a sobering, hands-on realization that relying on un-managed spreadsheets can be a dangerous dead-end street, as well as a strategic roadblock for a traditional tax department hoping to accelerate into a digital tax department[2] . Using the maturity levels for internal controls produced by the corporate fraud-focused Committee of Sponsoring Organizations of the Treadway Commission (COSO), high maturity levels of 4 or 5 require the use of robust, documented, and tested software[3]. Most self-developed spreadsheet tools and applications currently do not and cannot be technically modified to meet these requirements and should be replaced by standard software.

Robotic Process Automation (RPA) is an emerging software capability that captures and interprets data output applications for the purpose of processing transactions, manipulating data, and communicating across other applications or systems. RPA implementations generally require nominal upfront investments and can be implemented within a pre-existing IT infrastructure without having to make changes to the underlying digital processes. RPA is can be an ideal way to move from on-premise into the cloud or to support the migration of a traditional ERP system into an in-memory computing environment. For other tax processes, that are either too small for utomated solutions or for which no off-the-shelf software is available, RPA may be a sound long-term strategy to improve the tax controls framework.

Moreover, many rules-based, data-centric, and repetitive processes may soon be streamlined by other AI technologies, such as machine learning and computer vision. By augmenting human intelligence, AI has tremendous potential to support the digital transformation of tax by facilitating access to and interpretation of data, as well as potentially serving as an interface with tax automation solutions .

Job taskification and talent cloud

In the digital world, traditional knowledge worker roles can be "taskified" into smaller fragments or gigs. Specialized talent, sourced in a variety of ways, whether internally or externally and at differing costs depending on how specialized, can then be applied to those smaller fragments. Tax is a ripe environment for this approach. Various skills necessary for components of the tax compliance process, such as data extraction, calculation, review, research, and filing, can be acquired through alternative sourcing options (the talent cloud), including corporate employees, shared services centers, freelancers, robots/software, or third-party providers. With an adaptive approach, tax departments can select very specific skills sets (e.g., tax-technical vs. technological vs. analytical vs. broader business advisory) to address very specific issues or opportunities across tax operations.

Both trends—taskification and the talent cloud—are supported by today's growing millennial workforce who, due to an increasing desire for flexible working conditions, are often looking for more elastic arrangements. The on-demand talent economy offers companies an ability to tap into extensive networks of innovators, technical experts, and seasoned professionals. These arrangements afford companies greater flexibility in their workforce structure. Crowdsourcing platforms allow businesses to reach freelance technologists, marketers, administrative professionals, writers, and other personnel to find and bid on "tasks." Companies are already leveraging this trend, whether they be virtual recruiters or freelance taxicabs. Their platforms help individuals find resources in a bigger pool of resources who are ready to fill a need at a lower cost than similar traditional resources. For businesses, crowdsourcing platforms allow freelance technologists, marketers, administrative professionals, writers and other personnel to find and bid on "tasks."

Collectively, these trends have the potential to transform the way tax compliance is delivered. Imagine a future where a tax department can source non-strategic work through a shared services center, power certain repetitive functions through automation, and harness data to respond to tax authority audits and provide predictive analysis to internal stakeholders. Imagine using AI to search and recommend correct tax codes and identify exceptions, and to leverage crowdsourcing platforms to source services such as report writing and administrative support. That future is just around the corner.

"It (automation) would allow more people to move from compliance to planning roles. Rather than thinking about how to get the tax return filed properly, they can spend their time thinking about how to cut costs or improve efficiencies by looking at doing things differ
ently." Tax Director, Manufacturing, North America

This age of hyper-innovation and automation is changing the way companies operate, manage technology and data, and source talent, supported by the growing pool of connected global knowledge workers. These trends will enable tax departments to move away from transactional tasks and enable tax professionals to spend more time on strategic activities, including tax planning, advising other areas of the business about the tax implications of their decisions, and, importantly, the analysis of cross-border data in anticipation of tax authority scrutiny—tax authorities who themselves are more likely to employ robotics and AI to collect and analyze taxpayers' tax data.

A way forward for tax departments

So how can tax departments prepare for a more automated digital environment where costs and compliance turnaround time will be reduced by new sourcing models and advanced technologies?

Consider a **START** framework:

Identifying **Scalable** processes— To have a positive and substantial impact, tax departments should identify processes to be re-imagined and transformed using technologies previously described. They should be processes that are scalable, have the highest productivity potential, and can influence multiple outcomes with minimal incremental cost. Transforming the data extraction process is one example.

Prioritizing **Transactional tasks**—Automating transactional tasks, such as indirect taxes and certain aspects of tax information reporting, can free up time for professionals to focus on more strategic tasks.

Aligning with broader digital transformation initiatives—Any digital transformation activity in tax should support broader corporate goals and objectives, such as finance transformation or corporate restructurings.

Communicating the expected **Return on Investment (ROI)**—Quantitative and qualitative ROI will be key parameters for the business to prioritize transformation investments. Hours saved, data quality improved, impact of analytics are examples.

Re-skilling existing **Talent**—To thrive in the more automated digital world, some professionals will need new skills, such as technology-related capabilities, project management, strategic analysis, and more specialized tax technical knowledge.

The timing could not be better. In the face of increasing compliance requirements, tax departments have an opportunity to centralize data, consolidate technology platforms, and transform how certain tax compliance activities are accomplished, in alignment with similar digital transformation efforts likely already underway elsewhere in the enterprise. Yet, it is important for tax executives to help stakeholders understand that one size does not fit all.

By implementing new digital capabilities incrementally and demonstrating the positive outcomes of emerging innovations, tax departments can look to the future with optimism.

Endnotes

1. https://www.asug.com/news/sap-extends-maintenance-guarantees-fixed-rate-until-2025
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