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Tax function – positive return on sensible investment

By Campbell Rose and Virag Singh

New Zealand is currently experiencing an increase in M&A activity, and one outcome of this is the corresponding uplift in our tax due diligence (TDD) work. The aim of TDD is to provide an effective picture of a business's tax profile. Issues we uncover differ from one TDD to another – as no one business is ever the same as another. However, in recent times we have more frequently encountered an issue common across various businesses, of various sizes, in various industries: lack of a robust tax function.

By "tax function" we mean the person or team responsible for managing a business's tax compliance obligations and tax profile (including risk profile), as well as (where applicable) the processes, protocols and procedures employed to do so. The tax function will usually interact with other divisions of a business, including other parts of the accounting/finance team, marketing, legal, acquisitions/strategy and others.

Tax function not performing?

A business's tax function can be ineffective for a number of reasons, and it is not always due to being under-resourced. Although sufficient resourcing can help, often it is the simple, easy-to-do things that make all the difference, like having best practice procedures in place or having a clear "tax mission" for the business. For example, the risk of missing return or payment due dates can be virtually eliminated by developing and maintaining a tax management plan (we touch on these considerations further below).

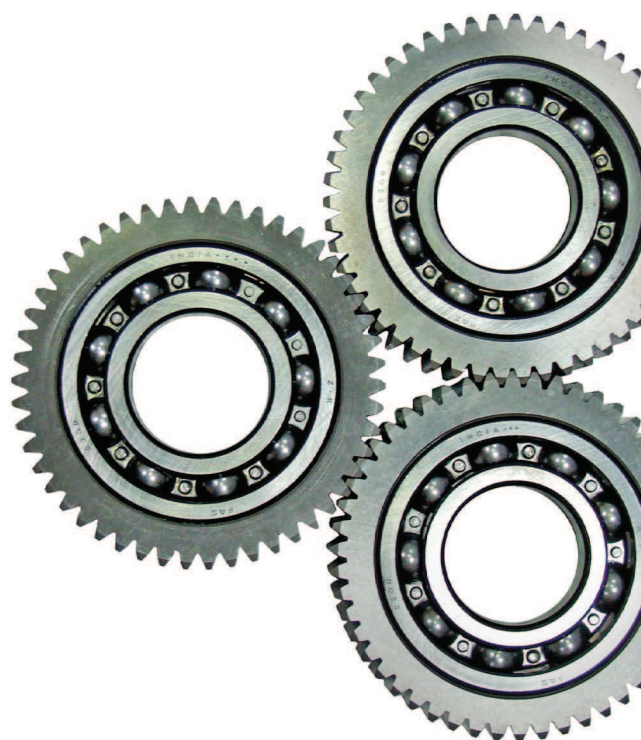
Our TDDs often reveal numerous and varying issues with a business's tax profile. What we have been finding is that a large number of these are ultimately symptoms of an ineffective tax function. This reflects the fact that the tax function affects all areas of businesses' tax profiles. If these issues are left unresolved, or are not discovered, for a number of years, then they can snowball and result in significant tax risks.

Recent examples of simple issues we have come across are as follows (all arose from an inefficient tax function):

- Tax documentation not being prepared and filed – e.g. CFC disclosures, and dividend and subvention payment documentation.
- Late filing of returns and rudimentary errors in returns, often leading to increased scrutiny from Inland Revenue into prior years or other tax types.
- Failing to make appropriate elections to use spreading methods under the financial arrangements rules.
- Failing to carry out basic checks on compliance with tax laws, e.g. overlooking the outbound thin capitalisation rules.

Why is the tax function important?

So, what can a well performing tax function do for your business? Most importantly, it will appropriately manage tax risk. It should also add real value to the business – the days of tax being a back-office cost >>



centre are long gone. There will always be pressure on senior management to achieve commercial objectives. To ensure all measures are taken to achieve those objectives, proactive management of the tax function is vital – it can have a substantial impact, for example, in maximising shareholder value. In the light of the current global tax environment – where, among other things, the OECD’s Base Erosion and Profit Shifting initiatives are ramping up - proactive tax functions have become even more important. Efficient, dynamic (in the sense of adapting to change) and transparent are key characteristics of a proactive tax function in today’s environment.

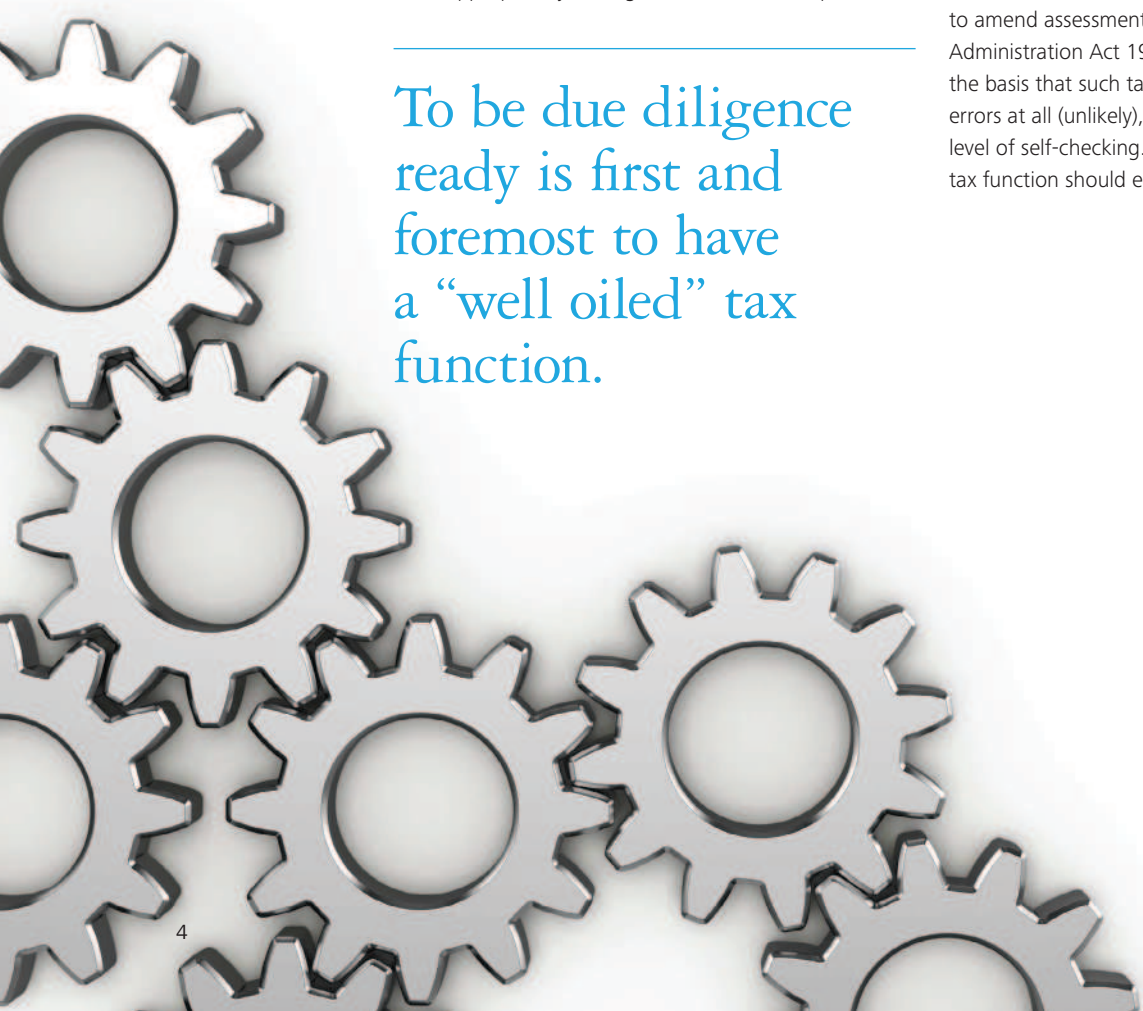
From an M&A perspective an effective tax function is important, regardless of whether you are buying or selling. In carrying out a TDD we will always look to form a picture of a business’s tax function. To be due diligence ready is first and foremost to have a “well oiled” tax function. From a purchaser’s perspective, even a small business can carry significant tax risk, and so an appropriately managed tax function can provide

a good deal of comfort. From a seller’s perspective, sale and purchase negotiations (including with any warranty and indemnity insurer) can also become problematic where the target business has inherent tax risk due to a deficient tax function.

Dealings with Inland Revenue also assume greater risk in the absence of an appropriate tax function. Not having best practice procedures in place can lead to hurried decisions in respect of tax positions. Where errors are made, quite apart from the technical issue in question, a lack of appropriate policies and procedures can virtually guarantee the imposition of a 20% tax shortfall penalty for failing to take reasonable care in adopting a tax position. It is therefore best practice to ensure that risks are being mitigated by giving tax issues an appropriate level of attention. Real costs can be borne by businesses that fail to do this.

Finally, we have recently seen Inland Revenue select taxpayers for risk review and/or audit on the basis that a low number of voluntary disclosures, or requests to amend assessments under section 113 of the Tax Administration Act 1994, have been made. This is on the basis that such taxpayers either have made no errors at all (unlikely), or are not undertaking a sufficient level of self-checking. Putting in place an effective tax function should ensure that “health checks” are

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part of a business's annual compliance risk mitigation strategy. PAYE and GST are usually areas that we have found are neglected in this sense; and these are often areas that will be targeted first by Inland Revenue in an investigation.

What can be done?

Taking a few small, well thought out steps can make a big difference in getting the best out of your tax function. It is important to start with a direction, a "tax mission", which sets out the objective of the tax function, and aligns it with commercial objectives and the board's appetite for risk. Once this has been given some thought, an effective tax management plan can be developed. This is a regularly reviewed, living document that contains details around recurring and one-off tax obligations, the allocation of resources, and opportunities for areas where value can be added. Tax management plans vary in their degree of detail, but at a minimum will ensure that best practice procedures are put in place. The "tax mission" and tax management plan go hand-in-hand in establishing and giving real meaning to the tax function, and providing direction going forward. They are also positive evidence that reasonable care is being taken in the management of tax obligations.

As noted above, a tax management plan will generally detail the allocation of resources – broadly, should a business have a full in house tax function, or should it be outsourcing all of the tax compliance responsibilities? Or some combination of both? There is no one size fits all in this regard. There will be advantages and disadvantages of each approach and, ultimately, what is most effective will depend upon the size and nature of the business, the "tax mission" and appetite for risk. The requirements of each business will differ and a tax management plan is often the best starting point in terms of analysing the most efficient allocation of resource for a particular business.

In summary

While we have recently come across a number of issues with the tax function in some businesses, in most cases small tweaks could have produced sizeable improvements. Whether you are gearing up to buy or sell, or simply looking at minimising your current and on-going risk, turning your mind to the management of your tax function can provide tangible benefits. Regardless of what you are looking at achieving, we would be happy to assist by carrying out an external review of your in-house tax function.

For more guidance, contact your usual Deloitte advisor – we look forward to discussing your tax function with you.