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CFO Insights
Six steps to transforming tax

As globalization accelerates, tax issues often become more complex and relevant to an organization's business strategies. At the same time, companies face demands by tax authorities for more information faster—demands that are only going to increase (see sidebar, "BEPS: What to expect next," page 2). They also face a growing number of IT challenges as commercial tax applications evolve to satisfy regulatory mandates.

In response, some leading companies have made a fundamental shift in the way they operate tax departments, transforming the tax function into a strategic business partner across the enterprise. And given that the implications of tax affect the financial and strategic decisions of many organizations, such tax-transformation activities typically are closely aligned with business strategy.

In fact, when participants on a recent Deloitte webcast (The Transformation of Tax: Something Big Is Happening Here, July 2014) were asked, "What is the biggest advantage to transforming the corporate tax department?" 26% of the 2,182 respondents indicated "having an enhanced ability to reach strategic and financial goals." Another 24% reported "enhanced business partnering across the organization," such as greater alignment between the tax and finance functions, and 22% cited "sustainability and efficiency of the tax function through cost savings."

For CFOs, tax transformations may seem a natural evolution. After all, many finance executives have gone through a finance function transformation and are experiencing the benefits of that strategic change. Not surprisingly, they are increasingly expecting the tax department to undertake a similar process and produce concrete results, such as completing the tax close faster. In this issue of *CFO Insights*, we'll outline the steps for such a successful tax transformation and examine how it may expand the function's responsibilities.

Expanding tax responsibilities

Tax transformation will likely expand the department's responsibilities from traditional tax functions, such as those related to the company's tax profile and tax planning, reporting, and risk management, to broader areas, such as the following:

Process, technology, and data. Many tax departments are looking to establish global tax processes, integrate technology across business functions, and maintain the quality of data used by the tax function.

Sustainability and efficiency. The focus remains on reducing the cost of the global tax function, delivering high-quality services at a low cost in mature areas, aligning with statutory accounting, and increasing tax partnerships across the enterprise.

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BEPS: What to expect next

Increasingly, governments are raising issues concerning transactions that have the potential to diminish their tax bases, particularly those that may have the effect of shifting profits from higher- to lower-tax jurisdictions. Their concerns have led to an initiative led by the Organization for Economic Co-operation and Development (OECD) to address so-called base erosion and profit shifting (BEPS), referred to as the OECD/G20 BEPS Project.

This project involves representatives of at least 44 countries—and covers "about 90% of the world economy, so it's a fairly comprehensive group," says Gretchen Sierra, partner, Deloitte Tax LLP.

Goals include consistency of international tax rules and outcomes, and greater disclosure surrounding cross-border transactions. However, each country has its own policy perspective and is responsible for enacting its own tax laws.

To date, papers on more than half of 15 planned actions have been presented to the G20 leaders, and discussion drafts dealing with the other seven have been released for public comment, with finalization of all papers due at the end of 2015. While the United States has not responded in the near-term, five countries have already enacted BEPS-influenced legislation, particularly with respect to interest deductibility.

Here are some of the other areas to watch:

Country-by-country report. The CbC report is designed to create a common platform for reporting across all countries, thereby providing tax authorities visibility into taxpayers' allocation of income across the globe. Despite a goal of transparency, however, controversy may ensue. When asked what their main concern with respect to the CbC report was," 28% of 1,476 participants on a recent Deloitte webcast indicated it was the cost of compliance, and 24% cited "increased controversy and double taxation."

Intangibles and transfer pricing. There is more work to be done in the area of transfer pricing as it relates to intangible property (and other matters). Issues to be addressed include ownership of intangibles, risk and capital, and recharacterization of transactions for hard-to-value intangibles. In its work, the BEPS Project has proposed changes to the OECD Transfer Pricing Guidelines, laying out steps to determine the return on investment from intangible property. During the webcast, participants were asked, "In considering the allocation of returns attributable to intangibles, which of the following functions is the most significant for your company?" Topping the list was "control over strategic decisions regarding intangible development programs" (18.7%).

Hybrid instruments. There may be instances in which hybrid instruments are used within multinational groups to take a deduction with no corresponding income inclusion subject to taxation. Apart from tax considerations, many US multinationals use hybrid instruments in their day-to-day business operations. Further study is needed to determine whether the taxation of these transactions should be affected by anti-BEPS measures. But as Tim Tuerff, partner, Deloitte Tax LLP, notes, "The need to make sure those transactions can be executed in the marketplace is quite important, independent of the tax ramifications."

Tax treaty considerations. Potential changes to the OECD Model Tax Convention are also part of the BEPS Project. Many countries view the US's limitation on benefits articles as under- and over-inclusive, and an outstanding question is whether the OECD will adopt a US-style limitation on benefits article or something else. In general, "there is agreement among the drafters," says Harrison Cohen, director, Deloitte Tax LLP, "that at a minimum every treaty should contain an express statement that the common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax avoidance or evasion, including through treaty shopping."

Tax operating models. New approaches are being developed to meet heightened expectations of sustainability and efficiency in traditional roles and to determine the appropriate sourcing mix for the tax department from various models, including in-house, outsourced, offshore, and shared services.

To make breakthrough improvements and transform the tax function, however, it is critical to enhance processes, technology, and data. One barrier: many companies often are not as automated as they could be with respect to data and the integration of tax processes with related business processes. That divide is often caused by a lack of tax-integrated enterprise solutions.

Another barrier: given that tax is likely the largest re-user of data in a company, it becomes difficult for tax professionals to make major improvements in data when it is not part of a larger finance transformation effort. For major transformation to be effective, companies need a baseline of tax technology, which many already have, and the vision to introduce new models, such as standardizing tax processes globally and integrating tax and statutory accounting with tax.

Six steps to effective tax transformation

To move forward with a tax transformation effort, there are six tactics an organization should consider incorporating into a strategic plan:

- **Define a tax department vision.** Focus on a shared vision of key characteristics that define what the department will look like in three-to-five years.

- **Understand perspectives and expectations.** Gain insight from tax stakeholders and customers, such as the business unit leaders. Identify challenges that can be addressed by transformation initiatives, including realigning stakeholder goals with the tax department's view of the future.

- **Assess effectiveness.** Confirm the key competencies of the tax department and determine what opportunities may exist to improve performance or create more value for the business.

- **Prioritize opportunities.** Consider the future tax department and prioritize a subset of responsibilities on which to focus based on the potential value to the organization. Then set priorities to help decide how resources should be invested to make the greatest impact.

- **Develop initiatives and mobilize.** Dig into root causes and identify potential approaches to address high-priority competency areas. Develop an action plan with key milestones and owners.

- **Confirm the department's commitment.** Identify areas of confidence and concern relative to executing against the tax department's initiatives and commit to specific actions. This often requires an assessment of the department's ability to deliver on initiatives, identify critical factors and risks, and develop mitigation strategies.

Securing buy-in and funding

Accomplishing game-changing transformation within the tax department requires the buy-in of other executives. After all, while tax executives are in a great position to lead, control, and drive a transformation, they need support from CFOs and others. From a process perspective, it is important to start securing buy-in from stakeholders immediately after establishing a solid vision for a tax transformation initiative. Upfront and periodic stakeholder interactions can help provide the knowledge needed to integrate the transformation with the business.

Gaining appropriate levels of funding and support for the tax transformation also is important for the transformation to be effective. Tax leadership should make clear the potential benefits of a transformation, including both hard benefits, such as possible tax savings, and soft benefits, such as efficiencies gained and risks mitigated. In addition, tax executives should work with their CFOs to define the return on investment (ROI) of a transformation initiative and measure against it. If the ROI is unacceptable, priorities may have to be reworked, which may limit the approach, but still provide certain benefits.

Moreover, the effort should be planned so that it aligns with the organization's goals, as well as with both the tax and finance departments' vision. For example, one organization used its desire to enhance its global compliance as a catalyst for tax transformation. The organization brought the statutory reporting and accounting functions into the tax department so that the two areas would be part of the same process. It also leveraged a service provider's technology platform to gain access to cutting-edge tools. The initiative not only supported the organization's overarching goal of enhanced global compliance, but also helped to free up tax resources for strategic support for the businesses.

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