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Tax operations evolution
Drivers, barriers, and building blocks

Continued globalization, growing demand for the effective use of resources, and an increasing emphasis on performance measurement are compelling business and tax executives to evolve their approach to tax operations.

Drivers of tax evolution

Tax organizations and operations evolve continuously—whether the result of formal, planned transformation or gradually as needs arise and environments change.

Exhibit 1 highlights some of the many concerns on the minds of tax leaders today as they navigate the evolving landscape. These questions reflect a very broad range of issues, from basic operating matters, such as efficiency and staffing, to emerging aspects of global tax governance, advanced use of tax data analytics, and global risk management capabilities.

In the past, economic downturn drove many business changes that ultimately had a ripple effect on the tax function. Today, globalization, risk, and real-time, current business priorities are key factors driving tax department evolution. Feedback from more than 400 clients and panelists at a Global Tax Planning Conference hosted by Deloitte showed tax risk rising to the top of tax department agendas—and, specifically, broader and proactive awareness of risk in all of its forms—or "tax risk intelligence." Exhibit 2 demonstrates some of the tax environmental factors that influence risk and drive tax evolution.

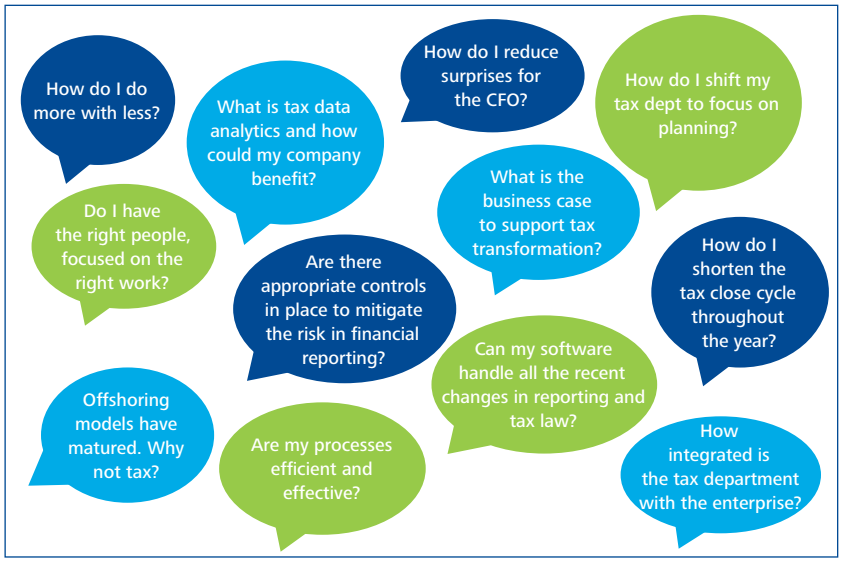


Exhibit 1: Challenges and concerns on the minds of tax leaders

Regulatory and risk environment:

- Board focus on peer tax rates
- Increasing aggressiveness of tax authorities
- Evolving global business models
- Increasing need for mobilization of global cash
- Corporate governance and tax avoidance debate
- Uncertain tax legislation
- Complex regulatory environment, such as FATCA, CRS and Country by Country reporting
- Management focus on tax reduction
- Increased focus on reputational risk

Exhibit 2: The regulatory and risk environment is driving tax evolution

In another recent Deloitte study involving interviews with tax executives from more than 250 global organizations, all executives surveyed (100%) rated the issue of quality of medium or high importance in determining how they organize and manage global tax compliance and reporting. Tax cost (95%) and the ability to add value (91%) were close behind. These findings highlight a classic dilemma for tax leaders: *How do we continue to ensure quality in an evolving environment while also managing a tight budget?*

In short, tax departments won't achieve the results they want by continuing to do things the same way; they will need to change how they work, they will need to transform their operations. But transforming a tax organization while at the same time sustaining service quality is a bit like trying to change a tire on a moving car— it's challenging!

Successful tax organizations are able to sustain performance in a continuous and unpredictable marketplace because they can rapidly and effectively adapt to change. These organizations possess several characteristics that enable them to adapt, including:

- A strong and integrated leadership team
- Scalable resources, tools, and technology
- Transparent communications
- Flexible service delivery models
- Performance benchmarks and analytics

Tax operating models

To meet multiple and often competing demands, more and more tax functions are adopting a hybrid operating model—supplementing the work of in-house corporate tax departments with some combination of other talent sources inside and/or outside the organization.

The terms co-sourcing and outsourcing often are used interchangeably. The common thread is that both involve third-party providers. At its most extreme, outsourcing turns the tax function or, more commonly, certain functions or processes, such as the generation of tax returns, over to a third-party provider. In contrast, a co-sourcing arrangement typically involves more collaboration between the in-house tax department and a third-party provider.

Another option is the use of contract personnel, or loan staff, to supplement in-house personnel and resources.

Two other key elements of tax operating models are tax centers of excellence (COEs) and shared service centers. Both share common management, usually in a central location. They can reside either in-house or outsourced to a third party. Centers of excellence tend to be more "one dimensional," providing a particular service—for example, the preparation of indirect tax returns or statutory reporting—to one or many countries. Shared service centers tend to be more multifunctional and include several tax disciplines and/or other non-tax functions in the same service center—for example, a Latin American service center that supports all taxes related to Latin American jurisdictions, along with perhaps finance and accounting functions.

Exhibit 3 illustrates several hybrid delivery options for supplementing the in-house tax department and the key advantages and disadvantages of each.

	Insourcing (captives)	Contract personnel	Co-sourcing (providers)
Definition	• A firm builds its own wholly owned and managed delivery center	• Provider's professionals work under the company's direct supervision	• A company contracts with an external provider for partial or whole tax processes • Defined outcomes, service level agreements and fees
Advantage	• Higher control/ ownership • Strict data control, IP protection	• Flexible and scalable resources • Control and visibility maintained • Business continuity risk mitigation	• Leverages provider's economies of scale • Reduced internal management overhead • Lower up-front investment
Disadvantage	• Higher up-front investment and steep learning curve • Lower cost predictability and deferred tangible benefits	• Investment in knowledge transfer	• Higher dependency on provider • Reduced control/ ownership

Exhibit 3: Hybrid delivery model options for supplementing in-house tax department resources

There is no one size fits all. Each solution is unique to a particular tax department's needs. For example, deploying in-house personnel and resources often makes sense when there is sufficient existing scale through a delivery center or when security is a perceived concern or a company needs to maintain strict control of its data. But it doesn't have to be an all or nothing solution. For example, an oil and gas company tax department could tap into an existing service center to handle something as specific as its motor fuels excise taxes. Or a company could utilize an existing finance and accounting (F&A) captive to do some "traditional tax work," such as legal entity accounting or fixed asset tax work.

Deploying contract personnel allows a company to maintain control and also to free up in-house professionals for value-added activities, such as planning or audit defense. It can make sense when a company needs to quickly increase capacity, but also in non-traditional situations, such as mitigating some of the risk of having too much work sourced offshore to one location or to one country where there is an offshore captive.

Co-sourcing enables a company to leverage tax knowledge and experience that it may not have in-house. It also offers the ability to focus company personnel and resources elsewhere.

Notably, all of these models may be implemented onshore, offshore, and/or near shore. They are customizable and unique to a company, so there are many potential combinations. Many large companies use a combination of models and locations either within their tax departments or through various sourcing models offered by service providers.

The offshoring dilemma. Offshore locations are emerging as a viable option for cost-effective resources. Implemented effectively, offshoring may provide benefits that include:

- Lower and/or containable costs
- The opportunity for in-house professionals to focus on value-added activities
- The experience and opportunity of working with a more global team
- The ability to take advantage of time zones to utilize a 24-hour workday

The benefits, however, don't come without challenges or risks. Historically, there were challenges in working effectively with offshore locations, including lack of infrastructure, language barriers, time zone differences, cultural differences, lack of virtual-teaming skills, limited U.S. tax knowledge or experience, and inbound/outbound visas. Those challenges are quickly being erased or mitigated as the offshoring markets mature, technology continues its rapid advancements, and workforces become increasingly global.

There is a lot of wisdom in learning from the experiences and lessons of early adopters, which have revealed common success factors for offshoring tax functions or processes, including:

- Obtaining leadership support and engagement
- Establishing effective, on-site leadership and management
- Focusing on recruiting, training, and retaining talent—both on and offshore
- Transitioning work that is conducive to offshoring
- Helping retained professionals envision their roles once work is outsourced
- Measuring results and periodically reevaluating the offshoring effort versus the benefits
- Defining and continuously refining processes

Building blocks for success

Successful companies focus on several key building blocks that support effective execution and sustained performance.

They establish a clear vision, mission, and goals. Vision is an overused term, but it is one of the most underrated components of enabling change within a tax department. It is extremely important to set the vision and the steps required to achieve it. That vision serves as a guidepost for the evolution cycle, from setting expectations to communicating with various stakeholders in terms that they can understand to measuring transformation success.

A vision should never be just a tagline on a wall. Alignment is critical. What is the business direction? What is the business culture? Who will you serve? What tax services will they need at what depth and priority? What market,

technology, and corporate changes are foreseen?

It also must have depth in both quantitative and qualitative elements, such as those in the table below:

Qualitative considerations	Quantitative considerations
• Transparency • Ability to report and respond in a timely manner • Succession planning • Work ethics of available personnel • Trends in technology	• Cash and/or permanent tax savings • Tax filings completed by due date • Tax-efficient business initiatives • Time and skills needed for tax management

Have a sound and comprehensive plan, a realistic transition period, and processes to sustain performance.
Where transformation efforts most often fall short is in execution. Exhibit 4 illustrates some key components of the planning and transition process—based on analysis of why change programs do or do not succeed. Important up-front steps include looking holistically across the whole tax process, then identifying and linking efforts with the customers and suppliers of tax process information. This helps determine whether to hybridize and in what fashion to build adaptability and scalability and, in turn, plans for attracting and retaining talent during the transition.

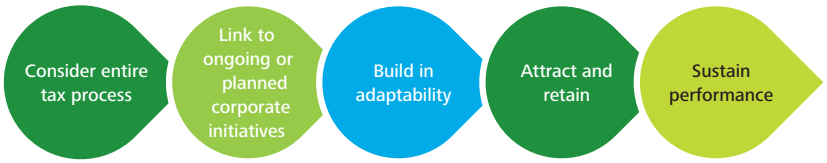


Exhibit 4: Key components of the planning and transition process

Understand and consider workload characteristics.
Understanding the tax types for which the tax department is responsible, as well as the volume, timing, and complexity of the work to be performed, is a prerequisite for estimating the number of tax personnel that may be required and at what skill and experience level—both experienced personnel required to perform high-value, complex tax core competency work, as well as less-experienced staff needed to perform data collection and other routine tax work. This exercise can also help identify those tax types and repeatable processes that may be candidates for transferring to a tax COE or shared service center.

Vision is an overused term, but it is one of the most underrated components of enabling change within a tax department.

Leverage the power of enablers.

Taking a holistic approach and leveraging the following four enablers is critical to a successful transformation. An effective approach for evaluating the strength of these enablers is to assess each of the following statements on a "leading practices" continuum of four stages: developing, defined, advanced, or leading practice:

People:

- People think strategically about the impact of tax on the overall business
- The tax department supports, develops and determines sustained technical knowledge is maintained
- Tax professionals are forward thinking and value adding; operating in the right role for their skill set

Process, Technology and Data management:

- Detailed data is available in the right electronic format and in the right time frame across platforms and geographies
- Processes and technology are more integrated within the tax function and with those of stakeholders
- Communications, performance and risk management, workflow, document and knowledge management are automated through technology
- Processes are subject to controls that are formally managed and enforced

Operating Model:

- The tax department's vision and strategy are aligned with the priorities of the business
- Globally centralized with appropriate leadership in place
- Effective use of talent resources via a shared service center and/or outsourcing

Risk & Policy:

- Tax Leadership has a seat in the board room
- Formal risk procedures and policies are in place
- Tax risk tolerance is aligned with the overall business

Sample financial measures	Sample organizational measures
• Address global tax burden and understand rate drivers • Anticipate and plan for earnings per share effects • Reduce cash taxes paid • Prioritize special focus items (M&A, IPO, etc.) and handle them effectively • Manage risks and communicate them effectively	• Meet cost, quality, and service delivery goals • Deliver effective training and career development • Retain key personnel • Leverage succession planning • Make overtime meaningful, not a penalty

Performance measures.

Performance measures tie all of these building blocks together. They drive the quality of the people and their ability to focus on business partnering to manage quality, risk, and value. But to be effective, performance measures must be continuous and proactive. They need to drive shareholder value, focus externally as well as internally within the function, and align with corporate goals. The table above highlights a few sample financial and organizational measures that may guide tax department transformation.

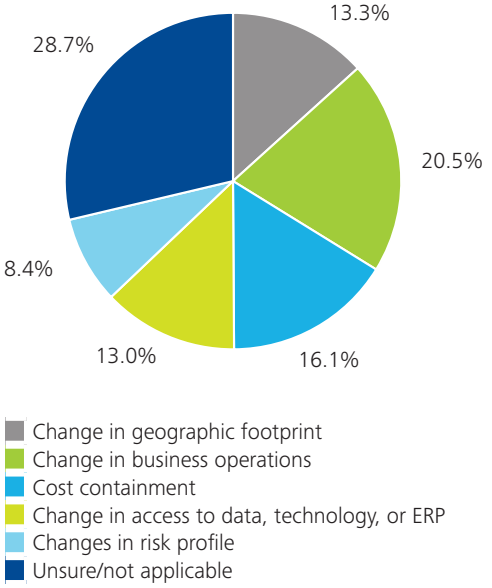
It is important to choose performance measures that are meaningful and clearly understood by business leaders. It is not surprising that the financial measures listed above correspond closely to business leaders' desires for "no surprises." It also is important to align performance measures to personal performance goals. Following these two principles, alone, will go a long way towards positioning the tax function to form an effective business partnership with the organization.

Tax executives' perspectives

Deloitte gathered viewpoints from over 1,700 Tax executives on drivers of evolution, such as global expansion and contraction, cost and resource management, adaptable and sustainable performance, and workforce dynamics. Following is a summary of respondents' perspectives and responses to polling questions.

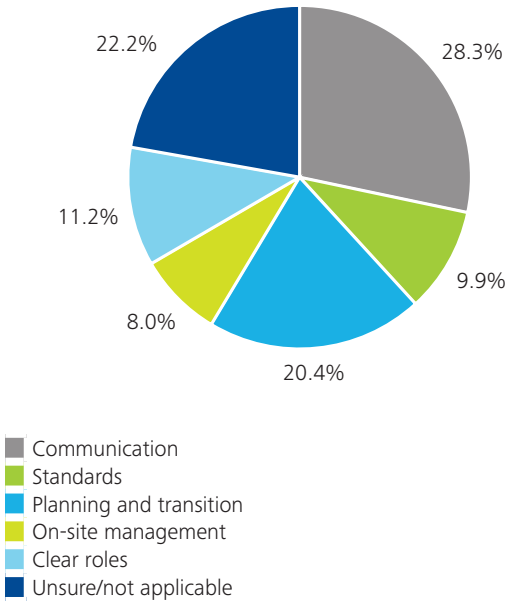
Tax departments are undergoing significant transformation, and there are many factors driving that change. Respondents were split with respect to the key driver of change for their tax departments. About 21% cited a change in business operations as the most significant driver, while 16% said the key driver was cost containment. Equal numbers, 13%, cited change in geographic footprint and change in access to data, technology or ERP system. Only 8% cited a change in risk profile.

What are the key drivers for change in your tax department today?



What are the keys to success for making such a model work effectively over the long term, including communication, standards, planning and transition, on-site management, clear roles, and others? What did respondents consider to be the most critical success factor? More than a quarter (28%) said communication, while 20% felt it is planning and transition. Smaller numbers cited clear roles (11%), standards (10%), and on-site management (8%).

Which of the following is the most critical for making a hybrid tax model work effectively over the long term?

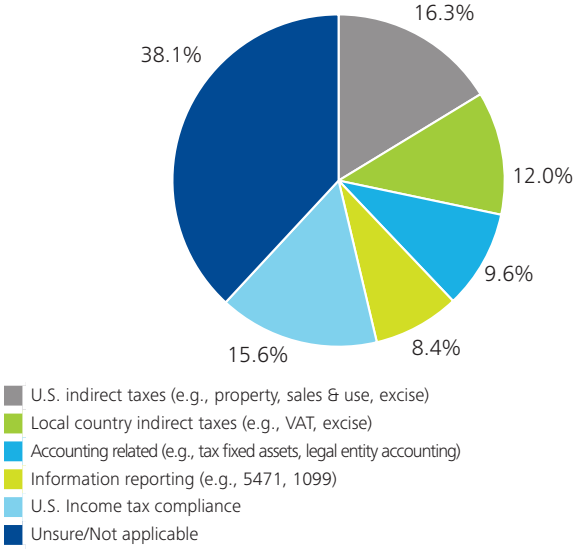


Source: Deloitte's Tax Operations Dbriefs webcast, "Tax Operations Evolution: Drivers, Barriers, and Building Blocks," held on March 14, 2013. Polling results presented herein are solely the thoughts and opinions of survey participants and are not necessarily representative of the total population.

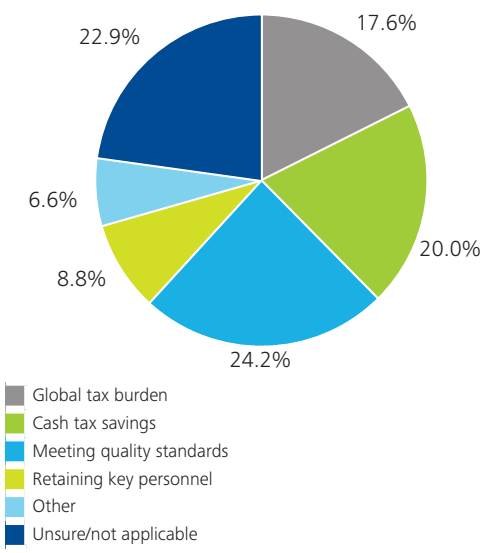
Hybrid delivery models are more the norm than the exception for global companies today. Respondents were asked which function they have most successfully sourced outside of the corporate tax function, and the responses were mixed. About 16% said their greatest success is in the area of U.S. indirect taxes (e.g., property, sales & use, excise), while almost an equal number cited U.S. income tax compliance. Another 12% believe they have had the greatest success with local country indirect taxes (e.g., value-added tax (VAT) and excise), while slightly fewer (10%) indicated it has been in the area of accounting-related services (e.g., tax fixed assets, legal entity accounting). Just 8% cited information reporting.

Performance measures tie together all the building blocks of successful transformation. Past research has shown that quality is a critically important measure for today's business leaders. Nearly one-quarter (24%) of respondents cited "meeting quality standards" as the most significant measure in monitoring the quality of their tax operations. Not far behind, though, at 20% and 18% are the financial metrics of "cash tax savings" and "global tax burden." Surprisingly few (9%) cited "retaining key personnel," a key to effectiveness in the evolving tax operating model.

What tax functions have you been most successful with sourcing outside of your traditional in-house tax department?



Which key performance measure is most significant in monitoring the quality of your tax operations?



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