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Building a Twenty-First Century Tax Function:

Riding the New Shared Services Wave

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Introduction

The focus for the creation of a financial shared services center has till now consistently been on the commercial considerations around centralization of key financial activities. The drivers behind this strategy were the cost savings, typically of the order of 25–30%, that could be achieved, together with the opportunity for standardization and process efficiency.

Under the pressures of spiraling competition and technological innovation, organizations are now beginning to go through a second wave of centralization, focused on identifying further sets of activities that can be packaged up and shipped to an established financial shared services model and determining whether or not an existing center can be relocated further offshore into a lower cost location.

Against this finance-led transformation, the tax function's place in the world is also changing. New regulatory requirements not only tie compliance processes more formally and visibly to strategic risk management, they also redefine how the tax function should operate. The overall result is an emphasis on both risk and effective tax rate management and a growing interplay of tax and finance processes.

The purpose of this paper is to propose that this second wave of process centralization and off-shoring should be a catalyst for the tax function to collaborate much more closely with their financial counterparts and to forge a genuine and sustainable partnership that begins to address some of the risk-related operational challenges faced by the tax team. The paper explores how tax could align itself with the corporate objectives around this second wave by reassessing those tax processes that it wants to standardize and/or automate and those areas that still need the technical expertise and innovation that the tax function provides.

A newly shaped tax team may emerge as a result; one whose basic processing activities are managed by an offshore tax team fully integrated with their financial counterparts; whose tax data is reused through automated links to the central accounting system and whose tax 'centers of excellence' focus on managing the organization's effective tax rate and providing decision support to the business.

The Financial Shared Services Model – Real Challenges for the Tax Function

“The ability of a tax function to ensure that tax figures reported in the accounts are correct is now the top performance measure of global tax functions, according to our 2006 Global Tax Risk Survey.”

Where are we now?

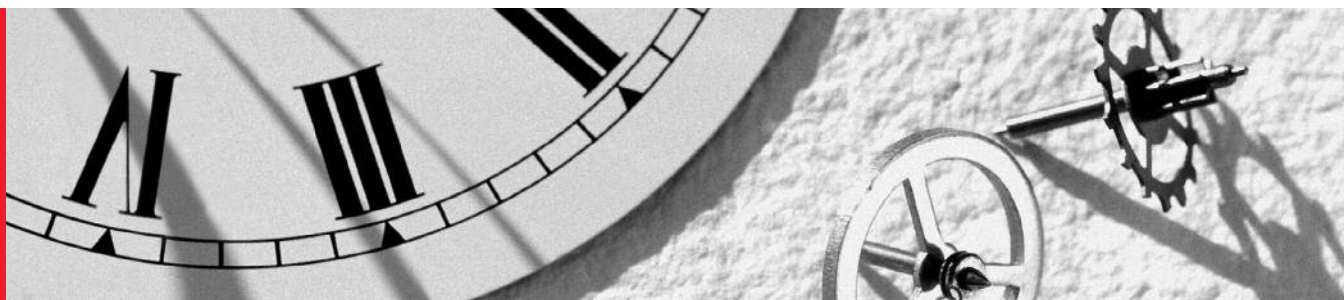
In the early days, the tax function often dealt with the centralized shared services model by treating the new ‘partner’ in a predominantly reactive mode – as a supplier to the tax function of key compliance data (both structured and unstructured) from which tax returns could be prepared for a given region or globally. This process could lead to lively debates around the format and quality of tax and financial data supplied from the center for completion of local tax filings.

Some tax functions rightly went further and addressed the question of which of their activities ought to be managed within the financial shared service center model and which should be handled by tax staff either at the headquarters level or by those in the larger business units. For some, this meant identifying and then breaking down key tax processes into their constituent parts and deciding which pieces could be centralized and which needed real tax expertise back in the heart of the tax team.

In recent years, the overall risk environment that tax directors face has changed dramatically. The ability of a tax function to ensure that tax figures reported in the accounts are correct is now the top performance measure of global tax functions, according to our 2006 Global Tax Risk Survey. Risks in this area are compounded by the pace of change and the fact that most jurisdictions have yet to resolve significant uncertainties in tax accounting rules and interpretations. But even leaving aside the obvious financial risks that could drive tax functions towards reporting process improvement, tax functions incur risks of other kinds that better alignment and interaction with the finance function could help manage.

- **Strategic risks:** How can the tax function work alongside the finance team in enterprise business planning, where failures could lead to misapplying or not considering the tax law in structuring a transaction or while performing due diligence?
- **Operational risks:** How can tax considerations be embedded in business processes managing, for example, transfer pricing issues or lack of formal alignment between tax risk policies and the enterprise risk equivalents?
- **Compliance risks:** How can tax truly stay on top of its compliance processes and examination issues worldwide?

The tax team needs more systematic and well-controlled processes, not only for greater cost efficiency, but also to prevent or detect potential tax risks. These raise some real challenges to the existing tax team, especially during a period of finance function transformation.



Challenge – Standardization and Centralization of Processes

Organizations are becoming more aggressive in their focus on standardization with a greater drive to squeeze out more and more cost savings. A tangible sign that a second wave of centralization is about to bite is the decision to review lower cost processing locations.

The opportunities for a best-in-class tax function to respond to process and locational change lie in two areas:

- first, a revisit of established tax processes to see what more can be standardized and ultimately managed centrally in the financial shared services model;
- and second, a wider look at what other tax processes, to date falling solely within the remit of the headquartered tax team, can be standardized and efficiently and effectively migrated to offshore locations.

Challenge – Greater Use of Technology

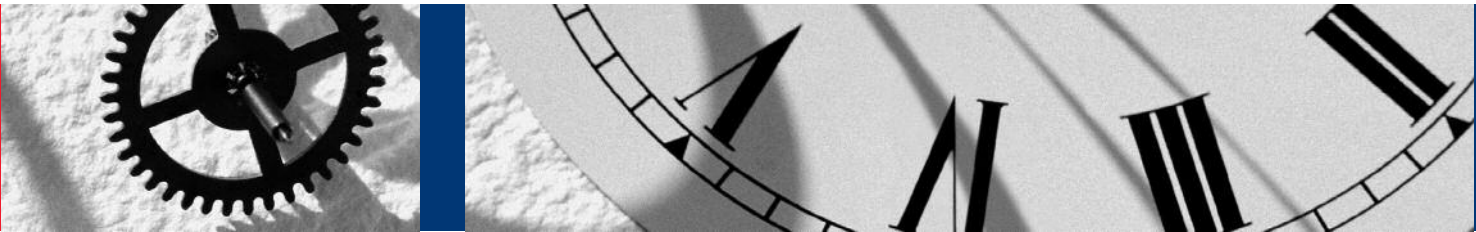
Process standardization is often the prelude not only to centralization but also to the launch of a single instance global ERP system. In the past, the exclusion of tax people from the centralization process often made the subsequent collection of basic financial data for preparation of tax filings an even more convoluted exercise. However, if the tax function is serious about enterprise alignment, it should embrace a global ERP roll out by taking an active part not only in defining tax data requirements but in effectively re-using data to support implementation of more streamlined, integrated and automated processes.

Challenge – The Need for a Strategic Tax Team

Our 2006 Global Tax Risk Survey showed that routine tax compliance and financial reporting now takes 54% of the average tax function's time, with financial reporting taking a much higher share of time at the expense of 'routine' compliance. Can the tax function generate cost savings not by taking headcount out of the tax team or by cutting other compliance costs but by focusing resource at the sharp end of the business – reducing the organization's risk profile and managing the real cost of tax, namely the effective tax rate?

If the organizational business model is subject to change, how can the tax function manage its team, present at least in part within a shared services model, given all the ramifications of running a disparate group? Should the tax team build new competencies around the adoption and adaptation of the new processes and technologies needed to operate in the new business model?

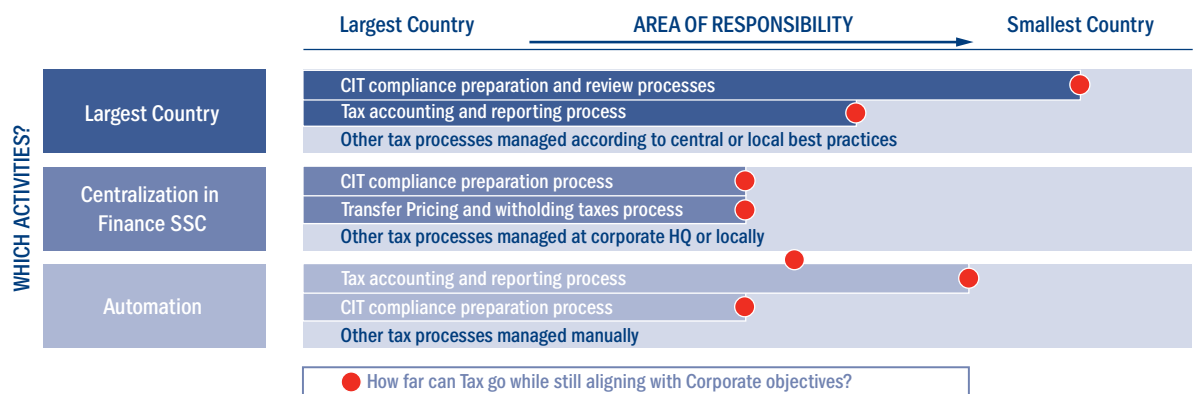
Rising to the Challenge: A Straw Model



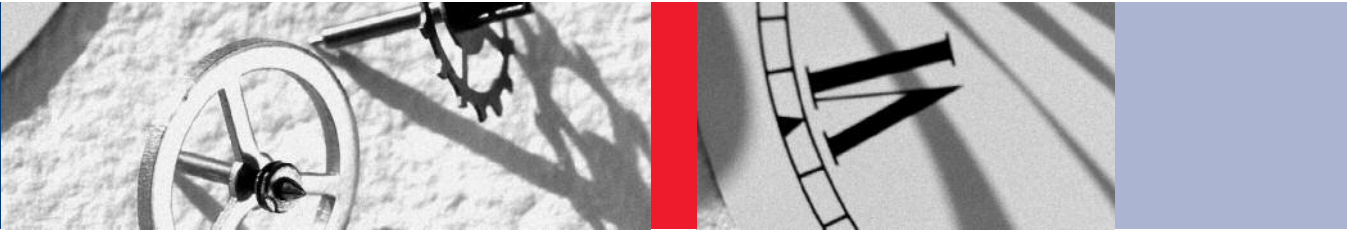
The tax function can respond to the new wave of centralization and the current risk environment by fundamentally revising its processes, technologies and people model. The straw model below distills our experience of embedding tax reporting and compliance activities into new and existing shared service models, while maintaining alignment to corporate objectives.

First, identify relevant, stand-alone tax function processes for which the team is accountable. Then consider the extent to which each process is capable of being (i) standardized, (ii) centralized and/or (iii) automated. This will require an assessment of many factors, for example:

- Do the processes require a high degree of interpretation and judgement?
- Are the processes labor intensive, or highly dependent on technology and easily automated?
- How many different inputs go into the process or task?
- Are the processes and controls well-documented and consistently applied?



“ The tax function can respond to the new wave of centralization and the current risk environment by fundamentally revising its processes, technologies and people model. ”



- What is the level of tax technical and ERP training required for the offshore location resources?
- How ready is the organization to make changes?

Finally, consider each process across an axis that begins with the organization’s largest jurisdictions and moves across from left to right to its smaller locations. At each point on this axis, the case for change needs to be answered against the overall business objectives that corporate headquarters is demanding, which might actually be to achieve standardization at all costs, to secure major cost savings, to focus solely on managing risk, to raise standards of quality and control, to provide consistency with SOX regulations or some combination from this wish list.

There is likely a point at which proposals for a shared service approach cease to make sense. In the example above, if headquarters solely requires cost savings in each operating location through a mixture of standardization, centralization and automation, the larger locations with high volumes of tax processes seem ripe for improvement across all three areas. For some countries, standardization may make sense but not for all of the function’s key tax processes. For others, the costs of any form of centralization may simply be prohibitive. For example, does standardizing and centralizing the process for the production of corporate income tax returns still generate cost savings in (say) Estonia or Algeria?

Success entails identifying the break even point for process centralization. Where there are two corporate objectives in play, say risk management and cost reduction, one will fail

at some point and become the limiting factor as to how far centralization or standardization can go. It should also be recognized that more routine, less complex tasks are the most likely candidates for early migration.

There will always be a residual layer of tax technical and strategic capability to be maintained across all locations. For the largest jurisdictions this is likely to be an in-house support function, while for the smaller locations this expertise will increasingly be derived from external providers who should be required to align themselves with the strategic objectives of the central tax team.

The role of this technical and strategic group may be less and less significant in many of the ‘commodity’ tax processes under review, but it will be needed to maintain local practice knowledge and relationships with tax authorities. Of course, the focus of the tax function on heavyweight planning and strategy activities should be accentuated by this whole exercise with ‘new’ time available to focus on innovation, managing the effective tax rate and ultimately forging a fruitful partnership with finance.

Finally, over time, the benefits of centralization may start to take root because the volume of process activity has grown to a critical mass, so reducing the payback period for centralization of these key tax processes. The standardized, centralized, automated boxes may expand down and across the model opposite as countries included or processes earmarked for transformation expand in number. This is therefore a dynamic model requiring attention on a regular basis.

The Future of Process: New Activities, New Locations?

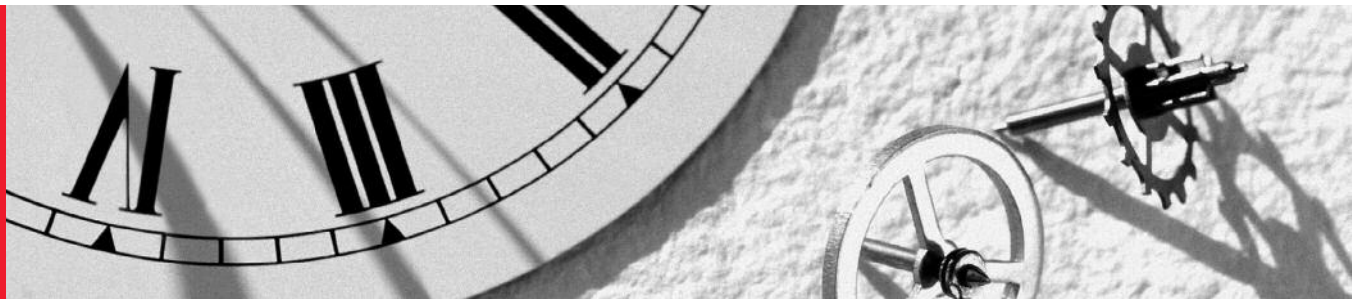
“If the demand for centralized tax compliance continues to grow, the day could emerge when all compliance is squeezed out of the tax team in the corporate headquarters and larger business units altogether.”

There are numerous tax related processes that could, in the right circumstances, be serious candidates for operating out of a centralized financial shared service center, well beyond the production of worldwide corporate income tax returns.

A forward-thinking Head of Tax could work with his or her financial counterparts to consider:

- the central conversion into local or IFRS GAAP of accounting data held, for example, in US GAAP
- the central production and review of corporate income tax returns for each relevant jurisdiction
- the design, roll out and policing of the organization’s worldwide transfer pricing documentation or knowledge management
- the centralization of monthly tax accounting calculations for material (or maybe even all) jurisdictions
- the management of all foreign compliance reporting requirements together with property and real estate compliance for US multinationals
- the management and tracking of worldwide withholding taxes
- the collection and screening of tax sensitive data and documents held in the shared service center’s financial systems – creating a type of tax data center that cleanses and validates source information before it is provided to prepare local country tax compliance filings
- the management of administrative tasks – tax team personal expense claims, budget management, travel administration etc.

If the demand for centralized tax compliance continues to grow, whether under the pressure of tax and accounting convergence or the more distant prospect of tax code harmonization, the day could emerge when all compliance is squeezed out of the tax team in the corporate headquarters and larger business units altogether and into a shared services model. If combined with proximity to a centralized finance team, the opportunity emerges for even stronger synergies.



For the tax function, the chosen location of the financial shared services location will be absolutely critical to determine the extent to which additional tax activities can be handled centrally as opposed to within the current structure. If one is looking at securing a real cost advantage, this places countries like the Philippines, Thailand or Vietnam at the top of the list. However, the more that skilled or technical activities are considered for centralization, the greater the requirement for appropriate competencies, including relevant language capabilities, to be available in the local marketplace. This is where India, Hungary, Poland, and (in due course) China come into play. In India, for example, there are some 15,000 qualified accountants and 50,000 articled and accountant trainees emerging each year together with some 3,000,000 graduates and postgraduates. How about a French tax desk in Bangalore?

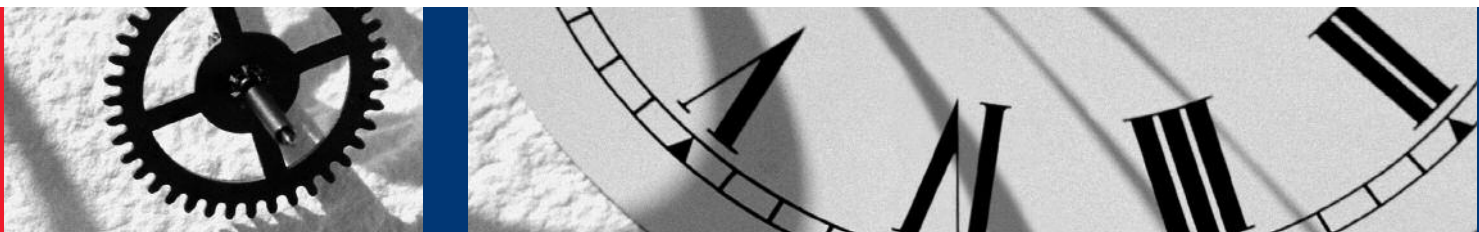
There are many challenges to overcome. Indeed, for many, the vision of a self-contained, central tax compliance and reporting team may currently be a step too far:

- Can critical mass with adequate, sustainable local knowledge and language capabilities be secured in one location?
- What about obscure jurisdictions, or even well-known ones, with a rapid turnover in regulations?
- What about entrenched internal interests and resistance to change in tax teams serving major developed jurisdictions?

Whether through the headquartered tax team or through externally sourced local tax expertise, there will remain a need for an on-the-ground, local presence close to the taxing authorities, for some time to come, although their ‘slice’ of the tax compliance and reporting process will become thinner and thinner as the confidence in a centralized model grows. In some emerging markets this relationship is critical, especially where local tax authorities have sweeping powers, for example the ability to halt the manufacturing activities of an organization in response to highly inaccurate tax filings or disclosures – a real cost of tax failure. In transfer pricing in particular, the need for local negotiating skills will remain paramount. Local teams retain knowledge of local protocols and experience of best practices and are ideally placed to build on their strong relationships with local fiscal authorities to the advantage of their organization. Realistically, only when these relationships, protocols and practices start to truly converge and be managed across borders, should the final piece in the centralization project for tax be contemplated. But given the progress already made (see our recent report, *Tax Administration Goes Global*), no-one should bet against the possibility.

One issue that emerges is how the concentration of multi-country data in a single center obviously carries with it the need to manage tax authority access. At least in the absence of simultaneous multi-country audits, the tax team would have to be able to ring-fence and redact material to enable full compliance with taxpayer confidentiality as well as with the demands of a local tax auditor. If and when the day of simultaneous audit does come, a process center with the right technical expertise on site would almost certainly have the edge in preparation terms over a mixed ‘hub and spoke’ model.

The Future of Tax Technology: Data Use and Re-Use



The tax team could also further enable and control its processes by integrating its data into a common tax technology platform to:

- automate data collection and adjustments and
- centralize access and re-use data across multiple tax activities.

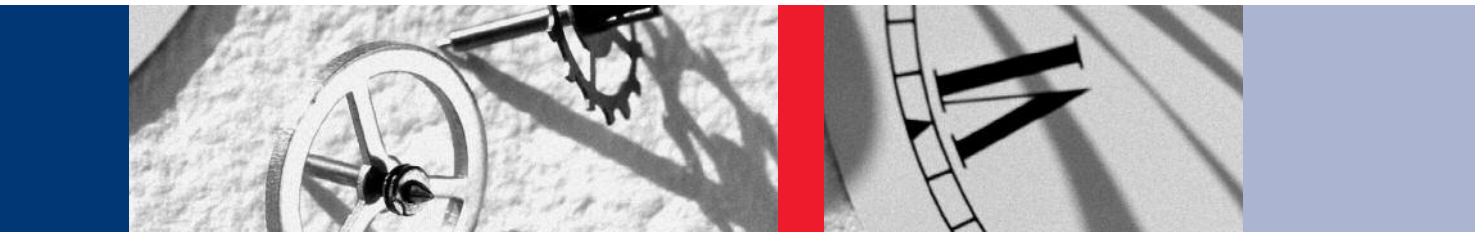
Automate data collection and adjustments

Once financial source systems can provide data that is properly formatted, tax relevant data could be mapped into a consistent format where automation rules can be applied to conform the data into the required format for specific tax activities. For example, automated rules and standard reporting templates could be used to facilitate the conversion of international GAAP to local GAAP rules or to support the production of corporate income tax and tax accounting adjustments, computations and schedules. Using this approach, the relevant files from the ERP system could also be extracted and mapped line by line into user access tools (such as reporting templates or technology tools integrated as part of the common tax platform) using a middleware or bridging tool, so that book to tax differences and other tax calculations could be automated. The resulting corporate income tax template could, for example, then be used as a basis for calculation of deferred and current taxes, with the resulting up to date tax charge and balances being uploaded back into the ERP system.

Centralize access and re-use data across tax activities

This whole approach facilitates the use and re-use of financial data. Tax accounting information extracted from one ERP file could be mapped to a year end financial template, converted to the relevant GAAP format and then used to calculate the current tax charge.

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This move to move contemporaneous reporting also results in greater integration of tax compliance and accounting processes. The resulting numbers could be stored in a central repository and then retrieved for subsequent use in preparation of the corresponding tax filings with an automated reconciliation between the forecast and final tax outcome. This does not only play to an efficiency agenda, but also helps to manage the risk profile of the tax function, particularly where weaknesses have been found in prior year tax numbers. Further, flexible access to tax data through a centralized data repository and reporting solution will also support the data needs of tax analysis associated with tax authority inquiries and tax planning activities.

Mapping ERP data through a bridging tool into a common tax platform like this does require some effort to set up initially. If done on a country by country basis for a multinational organization, with all the differing compliance and reporting regulations that apply, the effort might seem prohibitive. However, the adoption of a pragmatic 80:20 rule could mean that standard mapping templates for data collection out of the global ERP system can be produced which have general application over numerous, similar-minded and material territories. Those standard templates should then be reviewed, say annually, to ensure that they recognize when country regulations change so significantly that a standard template is no longer relevant.

This approach could also be extended to include new templates to track the level of intra-group trading, to identify the corresponding product margins or capture data, as required, for use in the calculation of tax payments or effective tax rate estimates. Mapping to transactional ERP files could facilitate the production of VAT returns with the data being retained and diagnostic tests run across the files to check whether or not appropriate rates of indirect tax have been charged. This move to greater automation does however require a real change in mindset by the tax function if it is to be embraced to its full extent.

Increasingly, language is no longer a barrier to the effective use of technology across borders. It is now possible for a centralized tax technician to map data into the requisite reporting schedules in English, applying the basic tax compliance rules for (say) Hungary, and for those same schedules to be automatically available in Hungarian to an expert reviewer logging onto the same web-based bridging tool from an office in Budapest.

People:

The Future Shape of the Tax Team

As finance teams strive to become less of a transaction processing business unit (with typically over 50% of activities being transaction processing focused) and more of a strategic advisor to the business, the tax team at headquarters could emulate this objective.

By teaming with finance, tax can, for example, engage more easily with the CIO/CFO about how to become intrinsically involved as key members of the decision support team. In the future, as more forward thinking global businesses start to focus on generating and managing innovation from within, both the tax and finance functions will need to address how they can play their part in this process.

As more activities are taken into a shared services model by the organization, more processes are standardized and greater automation is introduced, the competencies and skills needed by the tax team will need to change in response. In particular:

- There may be a greater requirement for a basic knowledge of underlying technology systems and infrastructure. When it comes to tax accounting in particular, this requires a real change in mindset so that talented, technical individuals are liberated from routine checks and start to think in terms of exception reporting and standardized tax packages.
- There may need to be champions of the standardized tax processes to monitor worldwide adoption of best practices, whether or not these processes are then migrated into a central shared services model. This will include process improvements and ongoing controls to prevent or defect potential tax risks across the organization.

- There will still need to be a strong emphasis on the availability of local country technical competence and even stronger relationships with the key local taxing authorities as more compliance returns are prepared centrally and the demands of the Board for global compliance visibility grow; this would apply just as much to indirect taxes and may push VAT and Customs expertise even more squarely within the remit of the tax function. This emphasis on visibility is already becoming apparent in the way that large multinational organizations are turning to third party providers with established resource and experience in the ‘more difficult’ countries of operation to manage their tax accounting and compliance risk in these locations.
- All tax people, however, wherever they sit, will need to feel part of the overall team whether or not they are also ‘owned’ by the finance function. The extended tax team will need an appropriate people model and consistent reward structures in place. If a new offshore arm becomes a reality, the tax function will also need to leverage the technologies (workflow and document management) that facilitate interaction and effective working across borders and time zones.

Finally, tax could take a leaf out of the finance manual on building a financial shared services model and construct its own ‘centers’. Of course, the headquartered tax team may regard itself as a central shared function in its own right. But once processing based tax activities have been offshored alongside finance, the remaining central tax technical expertise could be split down functional rather than geographic lines, with ‘centers of excellence’ for transfer pricing, due diligence or customs duties located close to similarly charged finance teams.



Conclusion

“ We believe that tax functions should now consider taking a leap forward that puts the tax function at the forefront of change in the organization, rather than following in the finance function’s wake. ”

The next wave of financial shared services, with its heightened focus on greater standardization and cost saving, combined with the new governance and reporting pressures on the tax function, creates a powerful case for change.

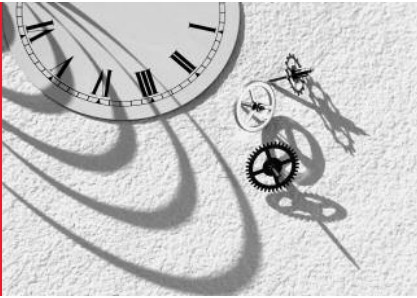
Tax functions can embrace this opportunity: but it is not the end. We believe that tax functions should now consider taking a leap forward that puts the tax function at the forefront of change in the organization, rather than simply following in the finance function’s wake.

Initial conversations with finance function equivalents are essential so that the business model is understood and the requirements for tax are factored into the planning for what could be a significant transformation program. The tax team may need to engage with individuals who have historically not been on their radar and define the value of the contribution that tax can make.

Ultimately the answer that the tax function will arrive at is an appropriate split between solutions that best suit each jurisdiction and which align to and support the objectives of the corporate standardization program. Whatever the outcome, the impact will be more tax work (especially processing) being done ‘centrally’, leaving the headquartered team to take on much more of a quality review and assurance role. All the questions around the shape of the ‘virtual’ tax team that were discussed above will now come into the debate and will need to be considered against the emerging model of the tax team and the location of its functions. Any model adopted will not be static: it will need regular review, ideally within the context of an enterprise-wide risk management framework.

Challenges will arise, but planning in this way, working alongside and integrating with the finance function, will take tax squarely onto the corporate transformation agenda, raise the profile of tax leadership within the business and ensure that tax operates in a model that can thrive and add real value to the organization.

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