



Clarity on Tax Function Transformation

Mind the gap

Institute of Accounting, Control
and Auditing



University of St.Gallen

Survey

Today's tax functions have to increasingly deal with new regulatory, process, data and people demands. In order to get ready for tomorrow's challenges, they have to rethink and redesign their current set-up. Together with the University of St. Gallen, KPMG analyzed the overall situation of today's tax functions in Switzerland. The transformation has just begun.



Executive Summary

KPMG's survey on tax function transformation gives a clear picture on the current situation of tax functions in large companies based in Switzerland. A total of 54 of Switzerland's largest companies contributed to the survey. The respondents were either CFOs or Heads of Tax.

The key findings of the survey can be summarized as follows:

Successful tax management entails much more than 'just' minimizing tax payments

The tax department is particularly successful if it not only achieves an adequate effective tax rate but also 'takes the load off' of operational management when it comes to tax-related matters.

Those in charge are expected to take on greater responsibility

Given the complex and risky nature of dealing with tax challenges, it is understandable that top management would like to see questions handled at subordinate levels. At the same time, however, the board of directors and executive committee also need to attend to these matters and get behind the tax department precisely because of the impact these could potentially have.

Transfer pricing is topic number one

Transfer pricing is one of the most important tasks performed by the central tax department. The general consensus, however, is that there is great potential for improvement from an organizational, procedural and technological perspective.

Major differences in how standardization and centralization of the tax function are organized

There are two conceivable conclusions: either the operational tax function is indeed subject to extremely different requirements and, depending on the situation, there are optimal organizational forms which are diametrically opposed. If that is true, then the question arises as to which form is preferable. Or the diversity found is based on historical circumstances and there are many companies which could improve their performance considerably by adapting in one direction or the other. The fact that a strategic examination of the operational tax function has evidently not yet taken place in most cases makes it safe to assume that many adjustments are probably still to come.

Considerable improvements possible in the area of technological support (IT)

The importance of developing and implementing IT solutions to support the operational tax function will grow greatly in the coming years.

The significance of external support depends on the matter at hand

No one-size-fits-all arrangement can be identified in terms of cooperation with external service providers. Depending on the matter at hand, the companies prefer to work completely independently, outsource all of the tasks in full, or seek out blended approaches.

The tax department is not equally responsible for dealing with all issues related to public levies

For each of the types of levies, either the central tax department or local finance functions and operational departments are better situated to handle a given situation. Consequently, not all issues related to public levies can be measured by the same yardstick.

Compliance with formal requirements comes at the expense of material work

As in many other areas of operations, tax departments apparently have a legitimate desire to focus more on the basics and value-adding aspects of their work rather than simply complying with and keeping up with administrative and formal requirements.

The necessity of transparency is acknowledged yet compliance is slow

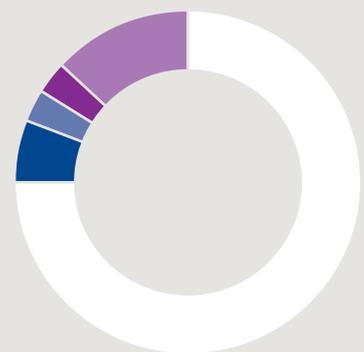
Companies are apparently under pressure to ensure accountability and transparency in the area of taxes, as well. Yet this topic is both sensitive and complex – not ideal conditions for communications that should be easy to handle. At present, most companies are being extremely cautious as a result.

Basis and statistics

High participation rate reflects the topic’s significance

Of the 54 of Switzerland’s largest companies that contributed to the survey 75% are headquartered in Switzerland while 13% have their international headquarters in the US. 78% generate revenue in excess of CHF1 billion and 52% in excess of CHF5 billion. Three quarters are publicly listed on stock exchange.

Location of respondents’ global HQs



Switzerland	75%
Germany	6%
Austria	3%
Other European countries	3%
North America	13%

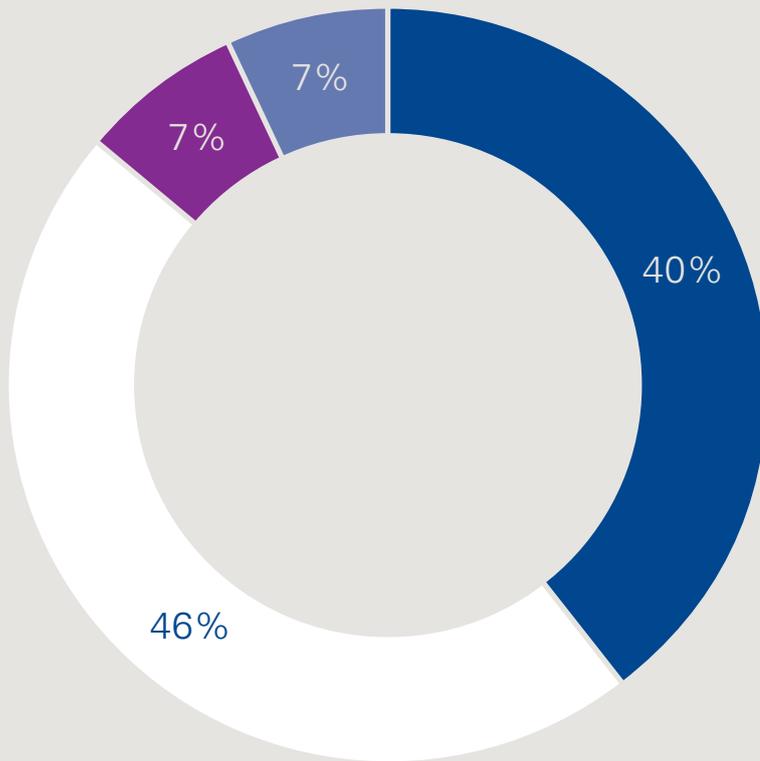
With effective tax rates of between 11% and 30%, tax-related issues are an important topic for 90% of companies that participated in this survey. Indeed, 87% of respondents rate their tax risk profiles as medium or high. The clear significance of the issues explains the exceptionally high response rate of one third of all companies contacted. In almost every case, the respondent was the highest-ranking employee responsible for taxes, typically reporting directly to the CFO.

The vast majority of participating companies have an international focus. 77% responded that their international business outweighs their domestic Swiss business, while two thirds have more than 50 foreign legal entities.

Only 10% of general management at the surveyed companies focus on an after-tax figure (e.g. profit after tax) as the leading financial key performance indicator. Most companies consider EBIT or EBITDA to be particularly relevant.

For leading tax functions, a large number of other objectives were specified in addition to the effective tax rate. At the forefront were the timely, accurate handling of tax matters, the prevention of tax risks and supporting operational management in tax-related issues.

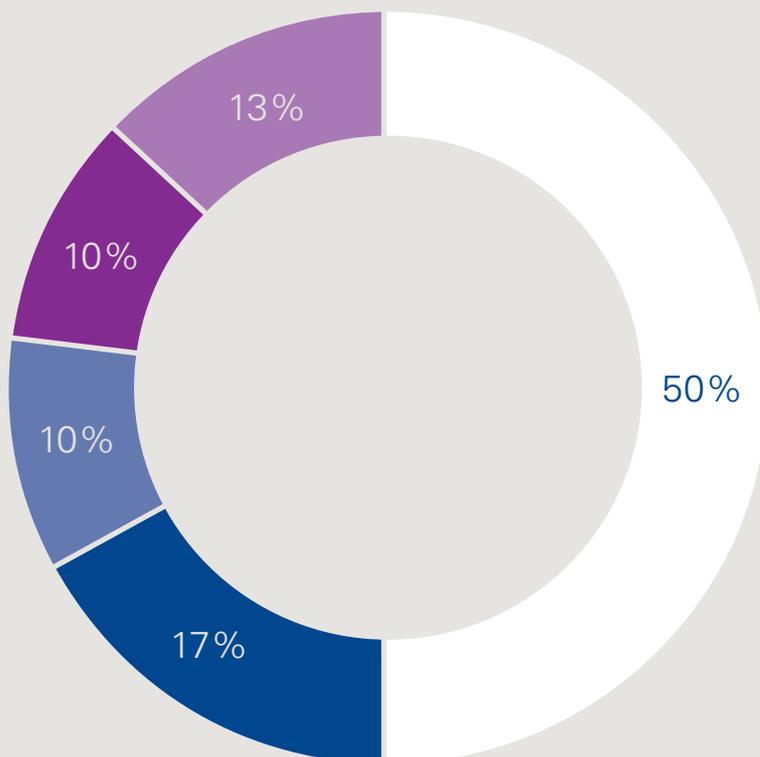
Respondents' job functions



More than 90% of respondents are in charge of all tax matters at their company, holding the titles Head of (Group) Tax, Tax Director or Vice-President Finance/Tax.

Director (Region/Group) Tax	40%
Head (Group) Tax	46%
VP Finance/Tax	7%
Other	7%

The leading financial key performance indicators for general management



Around 70% of participants' general management consider EBIT or EBITDA to be the leading financial key performance indicator. Only 10% focus on profit after tax. Except for effective tax rates, the tax function is mostly measured on non-financial KPIs.

EBIT	50%
EBITDA	17%
Profit after Tax	10%
EVA	0%
ROCE	0%
ROI	10%
Other	13%

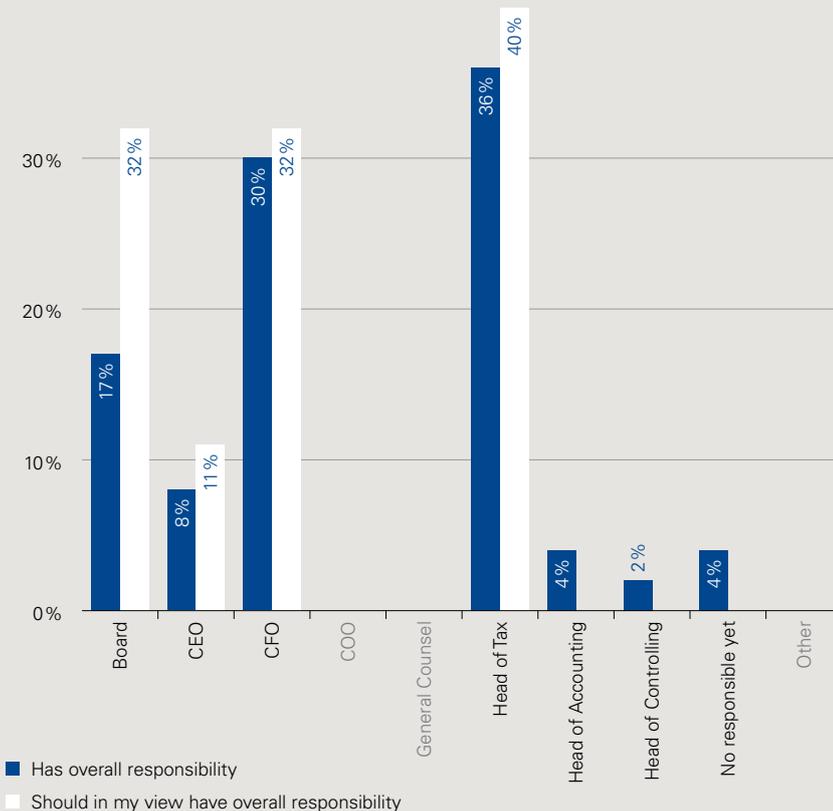
Call of duty for the board

Tax strategies need to be defined

Respondents would like to see greater involvement by their superiors. They believe that the board of directors in particular should play an active role in defining the tax strategy. This is because the board bears ultimate responsibility for all strategic decision-making while management should focus on implementation.

Further to the wish for the board of directors to be more involved in defining the tax strategy, the study shows that at nearly 75% of participating companies the Head of Tax never meets with the full board of directors. Instead, at around 70% of companies, the Head of Tax meets at least once a year with the audit committee. A more regular exchange with the board concerning tax matters would be more effective and reflect the importance of current tax-related discussions.

In terms of transparency, participants rated communication of the tax strategy to internal stakeholders as twice as transparent than to external stakeholders. However, 96% of respondents report that their CEO never or rarely reports about tax issues in the employee newsletter.



Current and preferred responsibility for defining tax strategy

Overall responsibility for tax strategy currently lies typically with the CFO or the Head of Tax. Board responsibility is limited and should preferably increase.



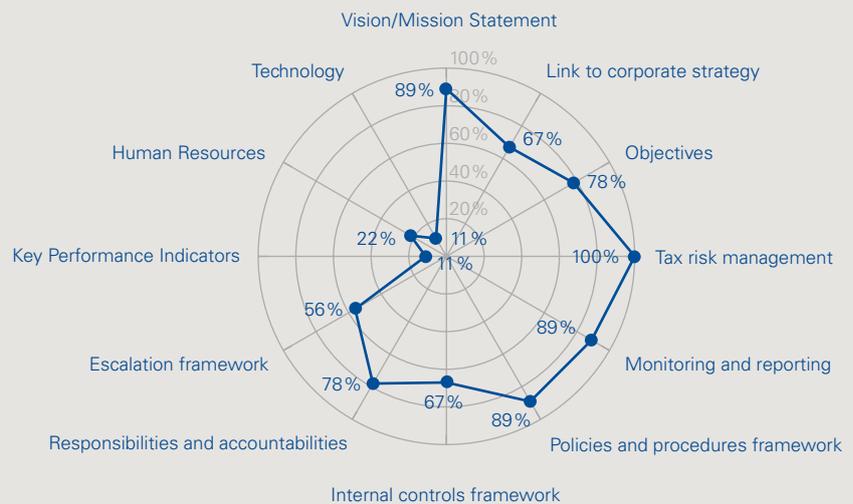
■ Yes	33%
■ No, not yet planned	44%
■ No, but planned within the next 6 months	22%

Two thirds of companies have not formally documented their tax governance

Just 33% of participating companies have formal documentation of their tax governance policy (roadmap, strategy, implementation plan), while 44% have not planned yet to put it in writing. More than 20% plan to document their tax governance policy within the next six months. Of the participating companies with a defined tax governance policy, two-thirds had first documented them in the last 1-5 years.

Components of a tax governance policy document

Existing tax governance policies primarily define tax risk management, the policies and procedures framework, and monitoring and reporting aspects. By contrast, coverage of technology and HR issues – as well as the definition of KPIs – in the tax governance policy document is very limited.



Not all aspects are yet covered in the tax governance policy

Companies that have already implemented a tax governance policy have a clear picture of what the policy covers. Most describe the following aspects in the policy:

- Vision/mission statement
- Objectives
- Tax risk management
- Monitoring and reporting
- Policies and procedures framework
- Responsibilities and accountabilities
- Escalation framework

The prevalence of these aspects suggests that companies have a clear picture of what needs to be covered by the tax governance policy. Other areas such as HR, KPIs and technology are usually not described in the policy.

Transformation has only just begun

No clear view over the organization of the future

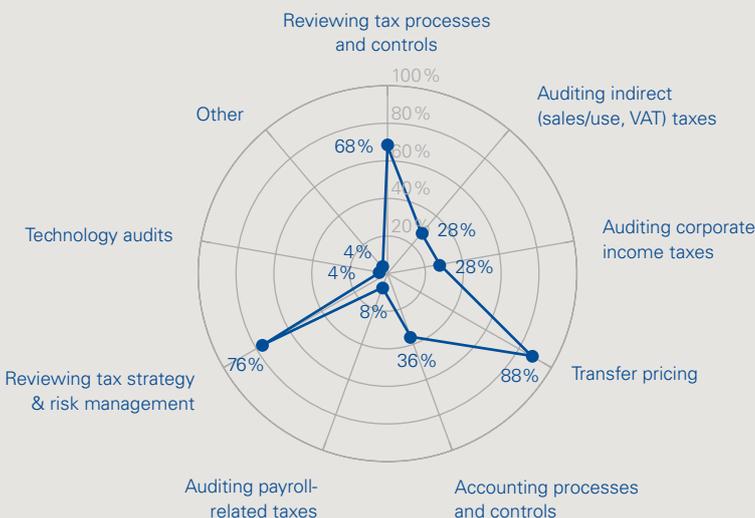
Respondents have a clear picture of the major challenges, areas of focus and drivers of change in the development of the tax function. No clear view exists, however, on what should be the organizational model of the future.

No topic is considered as important within the tax department as transfer pricing documentation and analysis. It is no surprise that the hottest topic is currently the new OECD requirements including BEPS and country-by-country reporting. Transfer pricing, the handling of regulatory changes as well as the implementation of efficient tax processes are seen as the primary upcoming challenges.

Interestingly, technology is not rated among the three main drivers influencing the development of the tax function, although technology also plays a major part in implementing efficient processes. Technology support has historically been quite simple and most work is performed using MS Office applications outside of the

normal financial systems. This should be viewed critically with regard to traceability and risk. Consequently, companies legitimately expect that they will make great strides in the next few years towards improving the IT support provided to tax departments.

Greatest uncertainty surrounds the tax organizational model of the future. The operational tax function is neither clearly (de-)centralized nor standardized to any great extent. Quite the opposite: From an organizational perspective, there is almost an exact balance between the number of companies surveyed that apply a centralized approach and those with a decentralized (local) tax function.

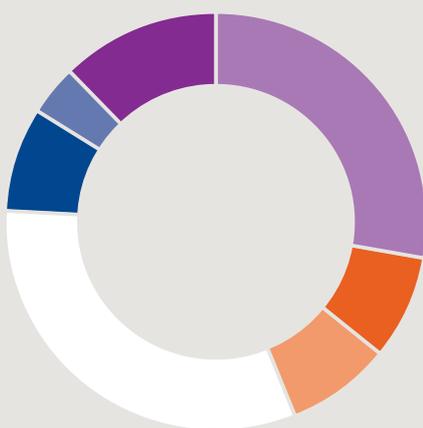
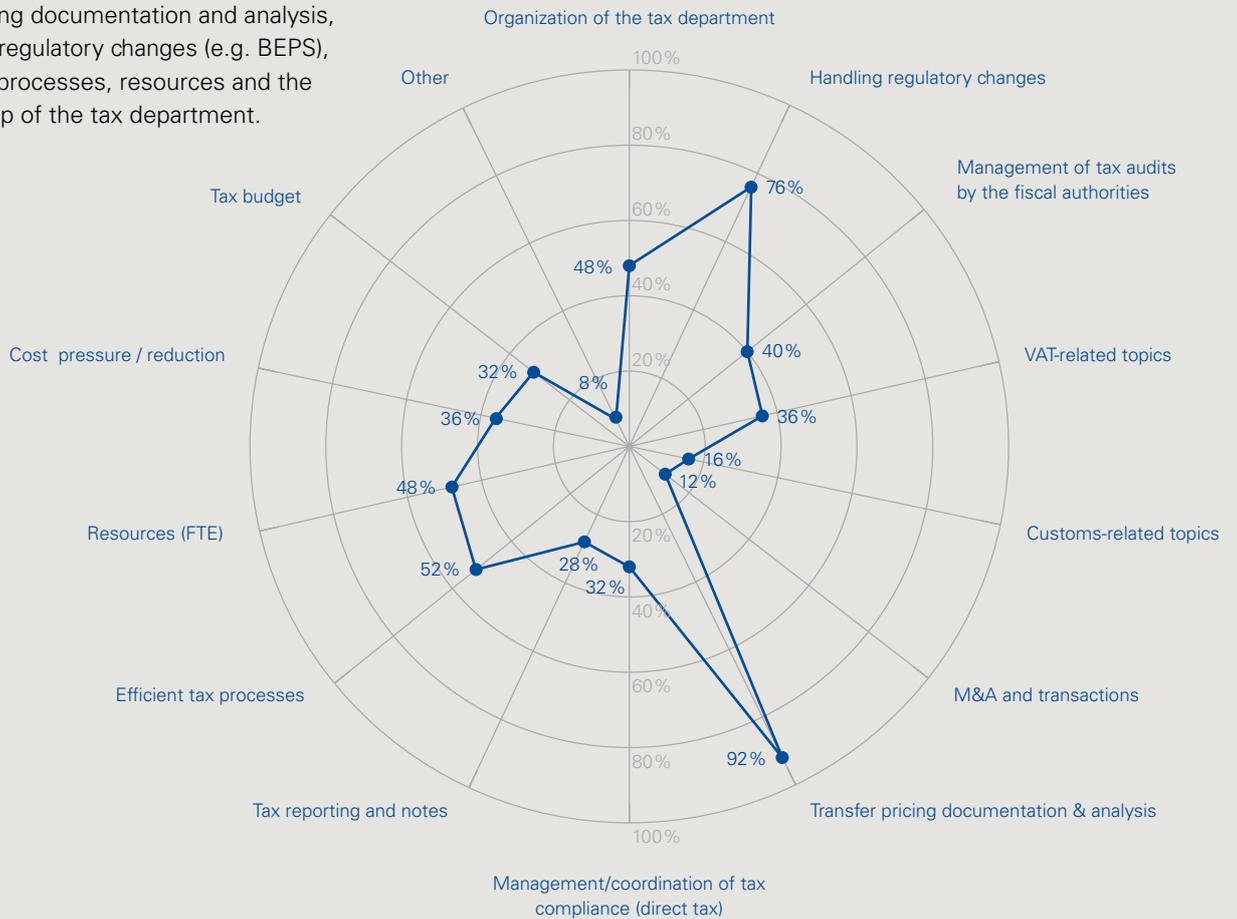


Drivers of the tax function's development

Environmental factors, costs, leadership and stakeholders and resources are the key influencers of how the tax function develops.

Major challenges to the tax function's organization

Participants consider major challenges to the organization of the tax function to be transfer pricing documentation and analysis, dealing with regulatory changes (e.g. BEPS), efficient tax processes, resources and the current set-up of the tax department.



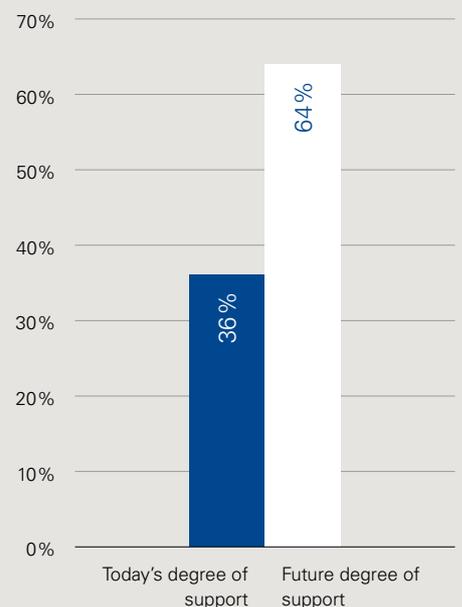
Decentralized versus centralized

Most companies currently apply a tax organizational model that is purely centralized or purely decentralized, at around 44% of respondents each.

Decentralized	28%
Regional hubs	8%
Regional hubs and shared services	8%
Centralized	32%
Centralized with global shared services	8%
Centralized with tax center of excellence	4%
Other	12%

Significant rise in the importance of technology

Participants expect technology and data support for the development of the tax function will be twice as important in the future.



Low standardization across tax departments

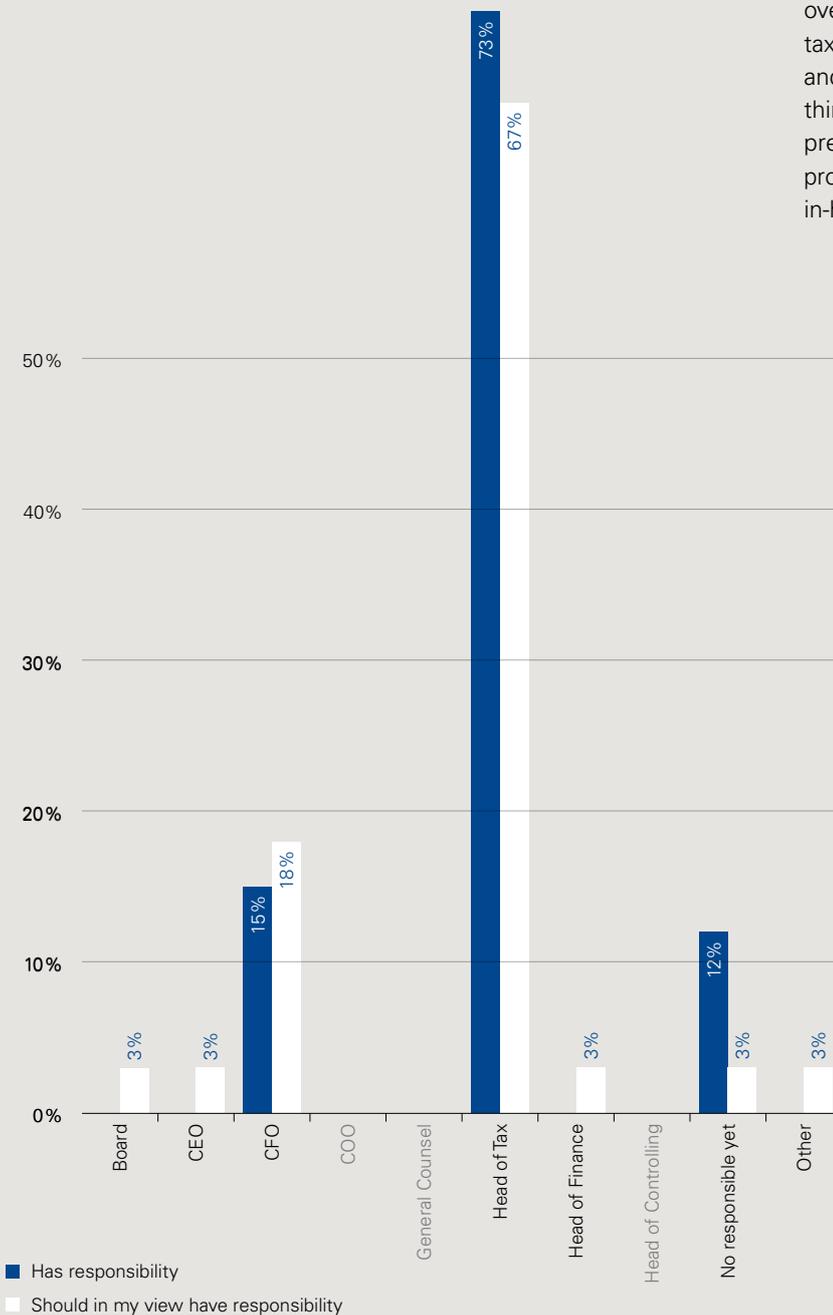
Particular tax processes tend to be outsourced

Overall, respondents consider the degree of standardization of processes, controls and technology to be rather low.

The coming few years will see a huge increase in effort to standardize the tax function to the same degree as other operational functions. The finance function for example has already set out the very beginning of this journey.

In-house versus outsourcing

None of the tax functions are completely outsourced or completely in-house. While overseas corporate income tax compliance and tax provision, expatriate/personnel tax compliance and litigation are outsourced in more than two-thirds of respondent companies, there is a clear preference to undertake corporate income tax provision, tax planning and statutory reporting in-house.

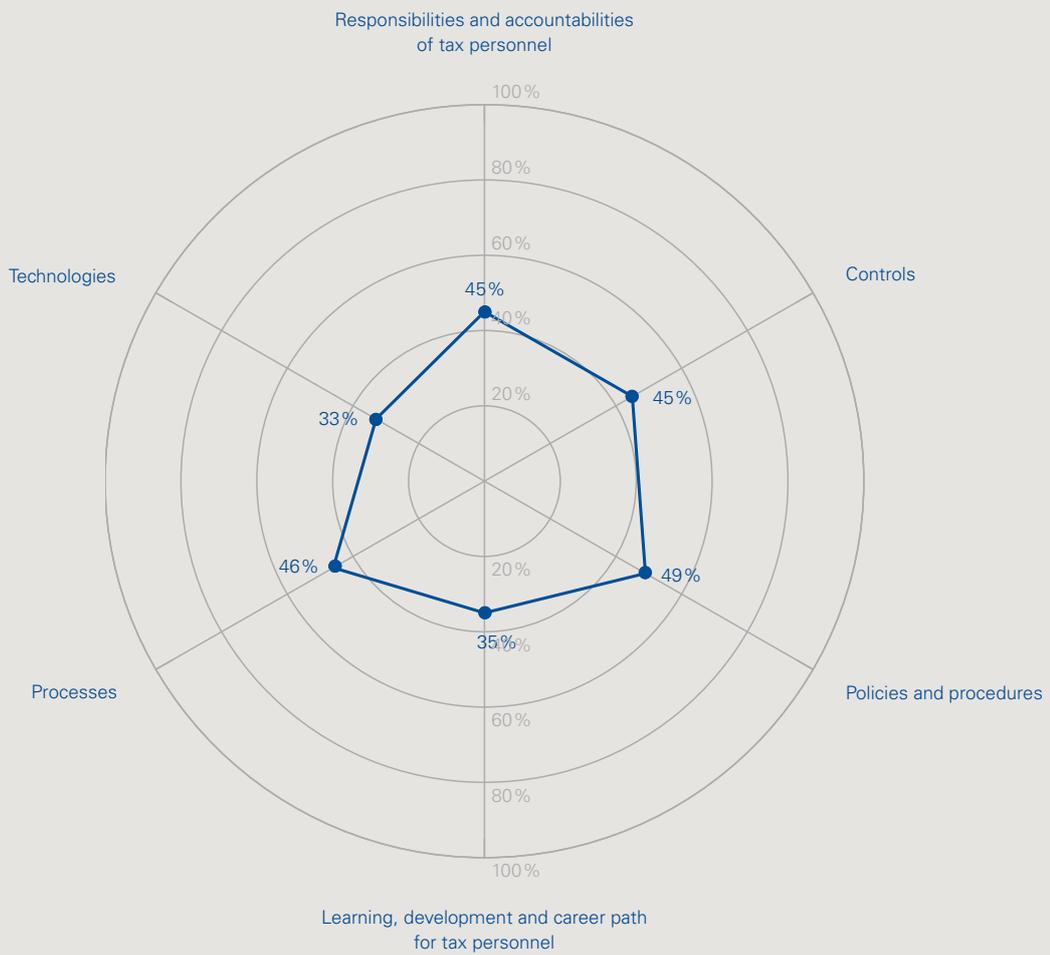


Responsibility for standardizing structures and processes

There is a trend towards moving responsibility for standardizing tax department structures and processes from the Head of Tax and CFO up to the CEO or the board.

Low level of standardization

Participants overall rate the standardization of their tax department to be rather low. Policies and procedures show the highest degree of standardization compared to processes.



Tax risks and compliance

Still a local task

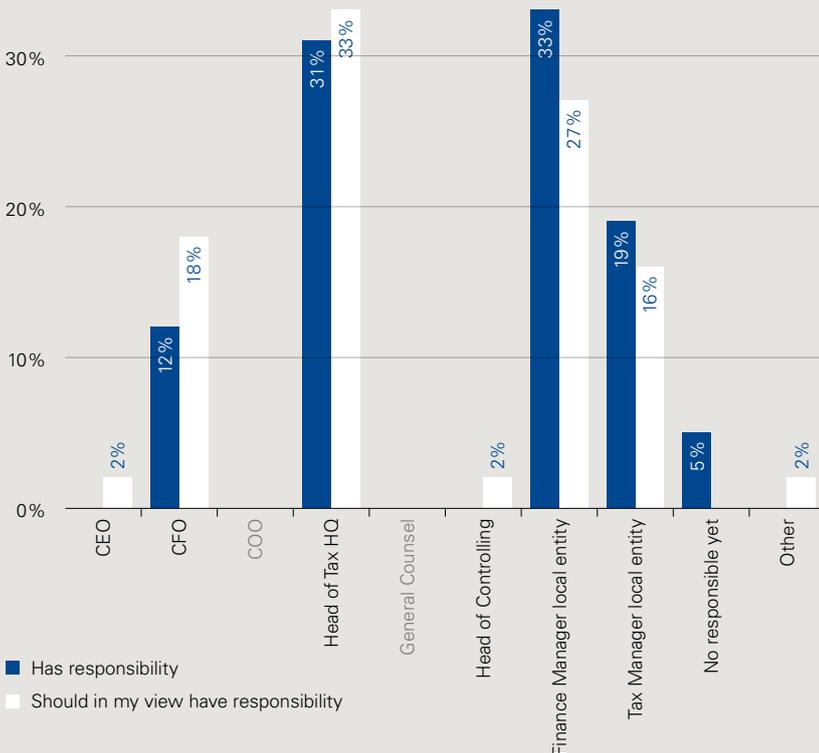
There is a growing trend to centralize tax compliance management and to move responsibility from local level to headquarters. There is a perceived need for customized technology for tax compliance.

Despite tax risk and compliance management being one of the tax department’s primary duties, these areas are not monitored more than four times a year. Whereas either no process (33%)

or team meetings/calls (33%) are predominantly used for global tax compliance for Swiss entities, more structured Excel questionnaires are mainly used for foreign entities.

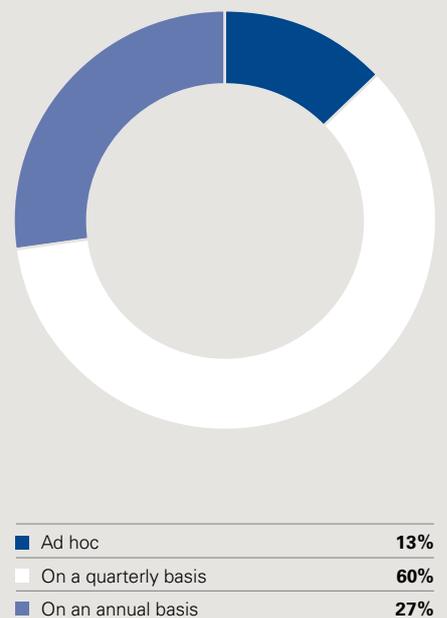
Trend to centralize responsibility for tax compliance

There is a trend towards transferring overall responsibility for tax compliance from local professionals to a headquarters-based Head of Tax or C-level deputy.



40% monitor tax risks and compliance only once a year or on an ad hoc basis

Most respondent companies monitor their tax risk and compliance on either a quarterly or annual basis.



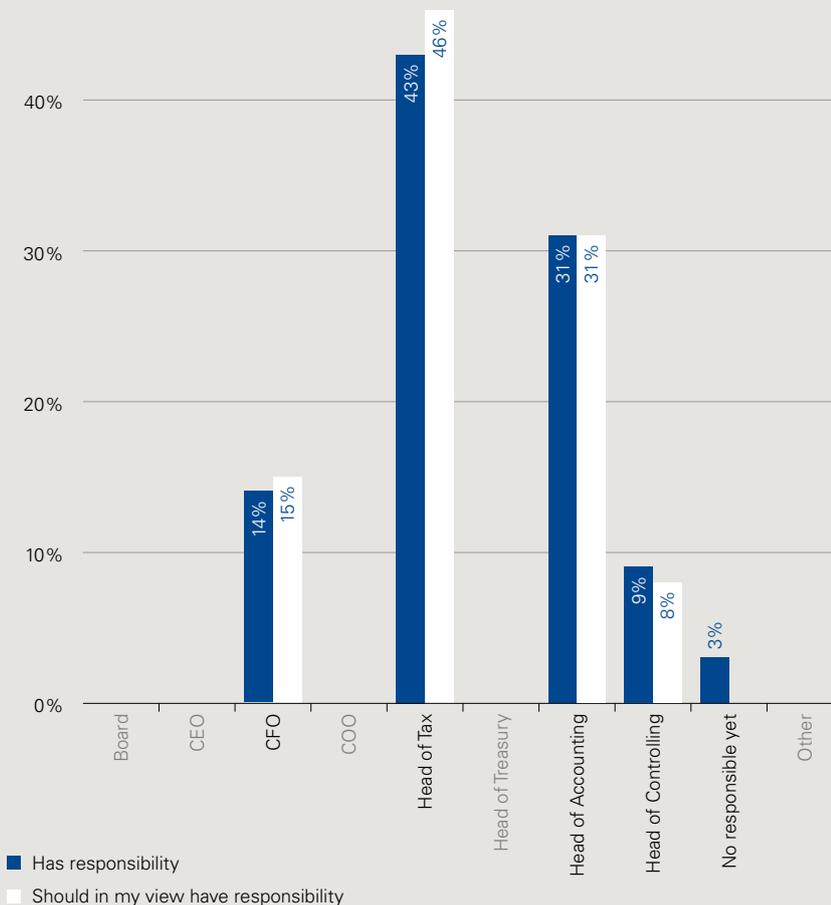
Tax financial reporting is time-consuming

The importance of IT solutions is growing

Microsoft Excel continues to play an important role in preparing tax financial reporting and associated notes. There is a strong move, however, to replace Excel-based applications by integrating tax reporting into the financial system or to implement a tailored tax technology system.

Today every second participant fulfils their tax reporting duties with the help of a financial system (ERP, consolidation system) together with Excel-based calculations for amendments. 13% still work only with Excel spreadsheets without any support from a respective IT system. In future,

most respondents would like to improve this situation by fully integrating the tax reporting within the financial systems or with the support of a tailored tax technology system.



Responsibility for tax reporting is shared by finance and tax

There is a slight trend towards moving responsibility for tax reporting from the Head of Accounting and Controlling to the Head of Tax or relevant CFO.

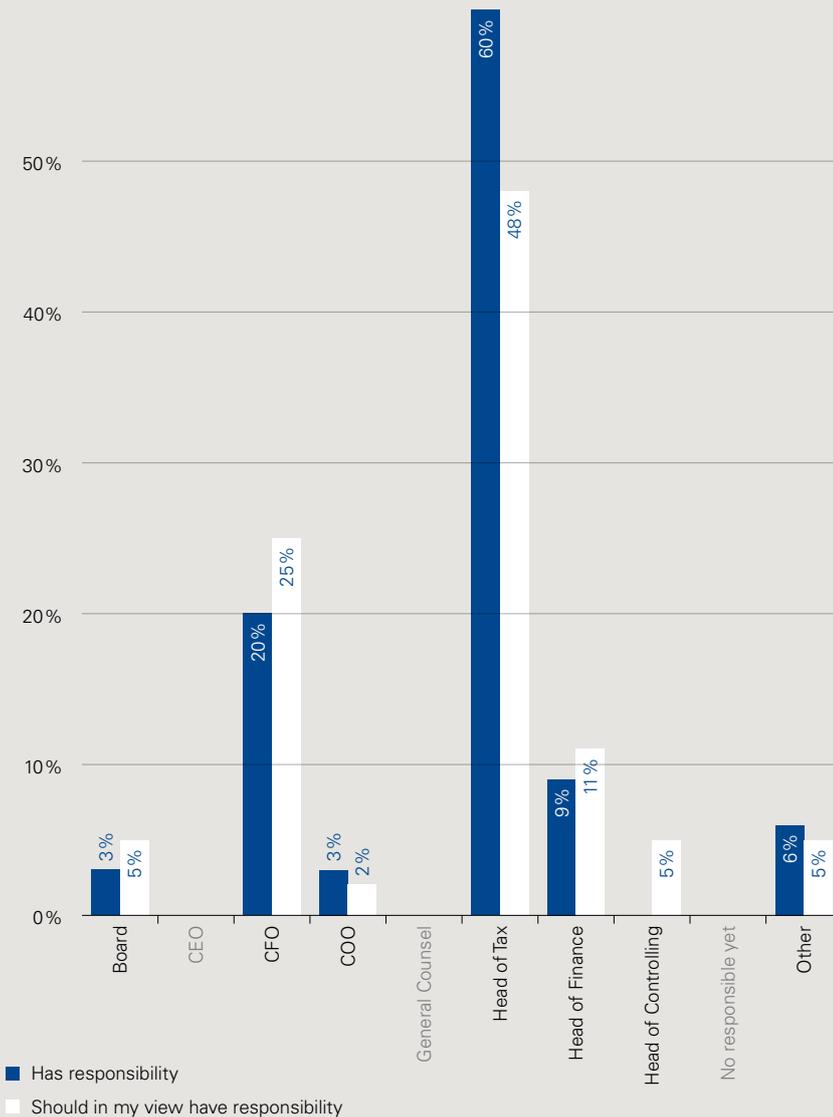
Transfer pricing: Today's biggest challenge

Mainly an in-house task

Transfer pricing is seen as the biggest current challenge. This explains the trend towards moving responsibility from the Head of Tax to the CFO and the board.

Involvement in managing the transfer pricing system – the determination of pricing methods and levels for intercompany transactions by means of transfer pricing policies – as well as the preparation of transfer pricing documentation is clearly seen as a task for the group tax department. Significantly less involvement is seen by local entities and the finance department.

No respondent operates standardized transfer pricing reports across all jurisdictions within their group. As with most other tax processes, MS Office plays an important role in transfer pricing documentation. However, respondents plan to substitute simple MS Office software for a customized or specific system of documenting transfer pricing.

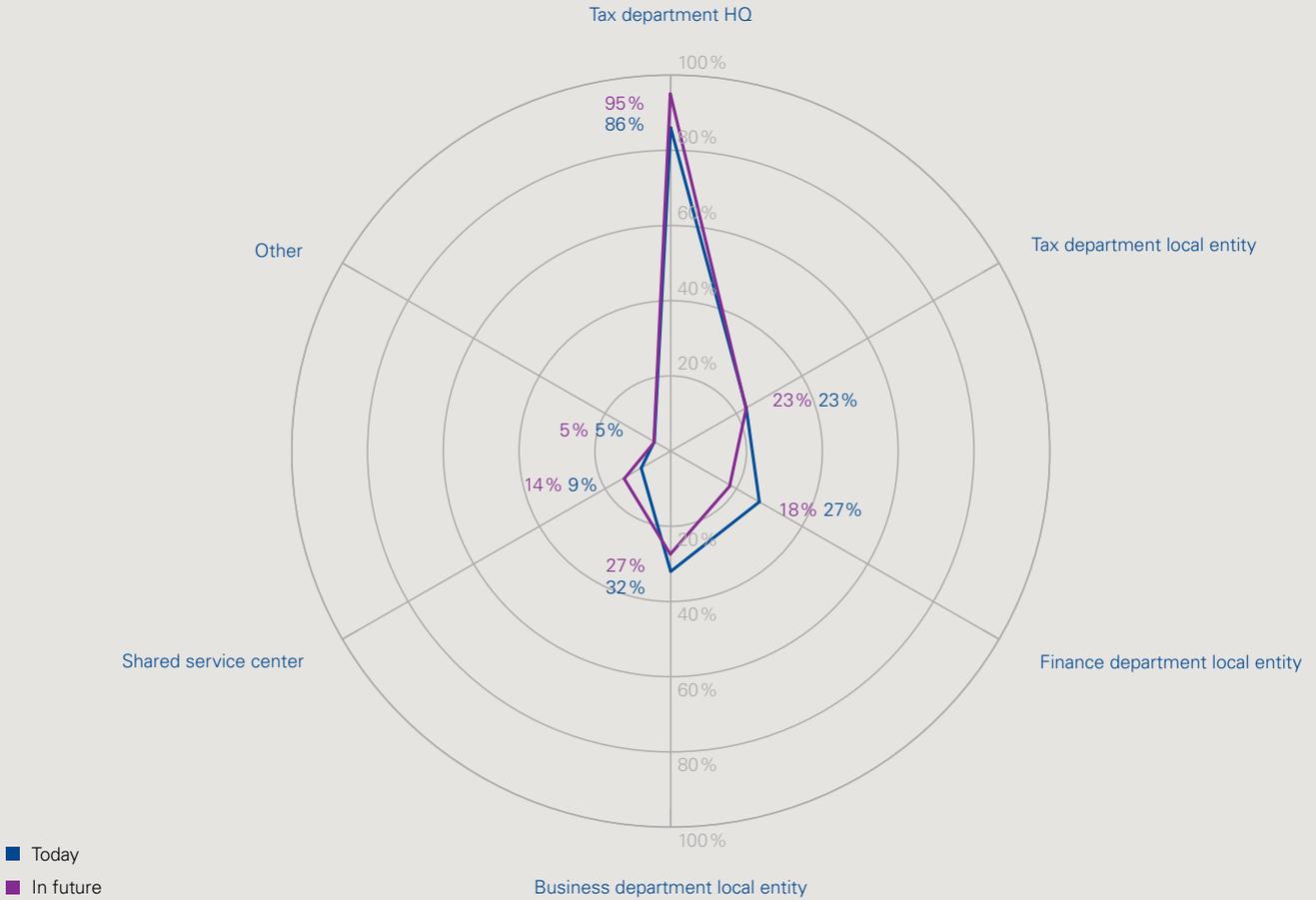


Tax directors are currently in charge of transfer pricing

There are moves to shift responsibility for transfer pricing from the Head of Tax to the board, CFO and Head of Finance.

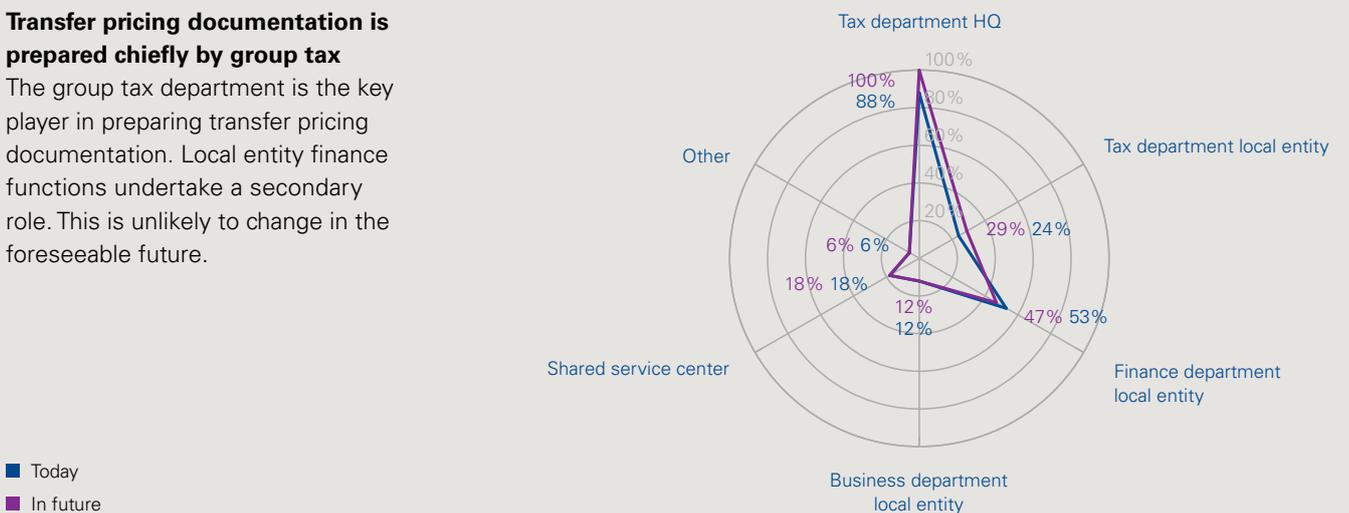
A group's tax department governs transfer pricing

The group tax department manages the transfer pricing system. This is unlikely to change in the foreseeable future.



Transfer pricing documentation is prepared chiefly by group tax

The group tax department is the key player in preparing transfer pricing documentation. Local entity finance functions undertake a secondary role. This is unlikely to change in the foreseeable future.



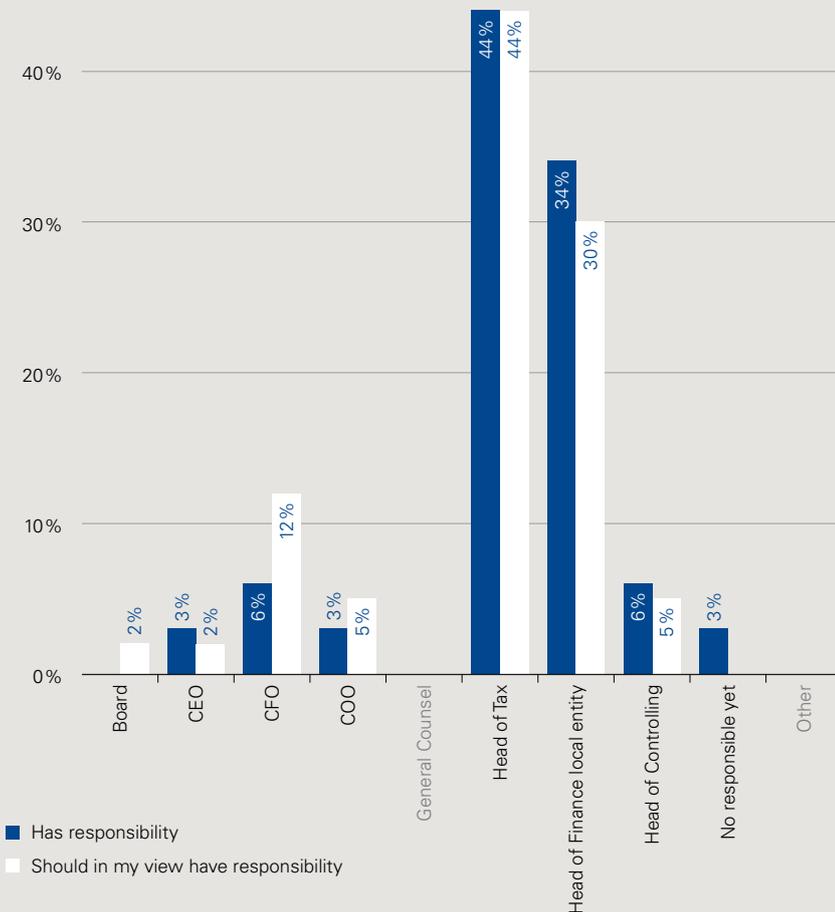
Indirect tax: Responsibility versus management

Management of indirect tax varies considerably

Respondents indicated that VAT, customs duties and excise duties are mostly handled by either the group Head of Tax, the Head of Accounting or by the local finance department. In some companies the Head of Logistics is the named managing function for customs and excise duties.

Responsibility for indirect taxes is held by either the Head of Tax or at a local level

The trend is to move responsibility for indirect taxes from local finance functions to the Head of Tax, CFO, COO or the board.



Desire for value-adding, forward-looking tax work

Tax is occupied by administrative requirements

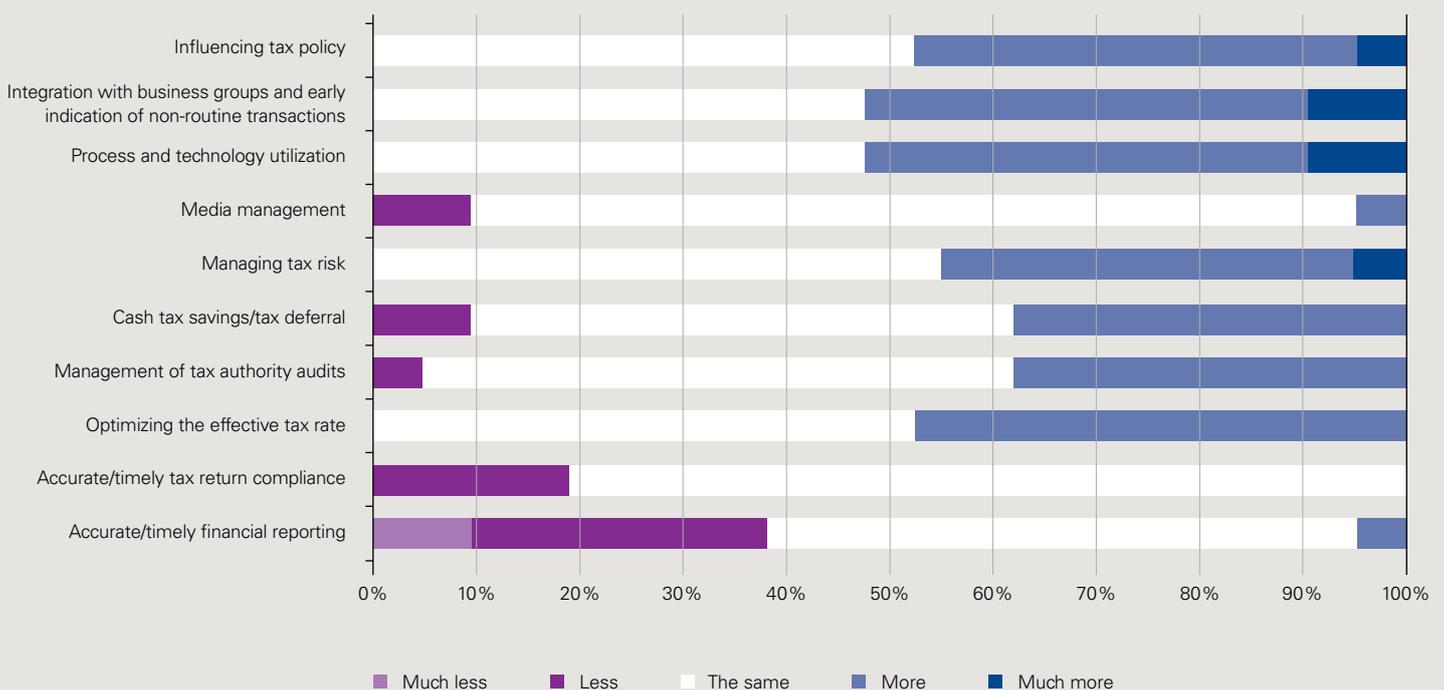
The feeling among tax departments is that too much energy is spent on accurate and timely financial reporting, tax return compliance and the filing and documentation of tax data.

This comes at the expense of activities that are viewed to be more valuable, such as optimization of effective tax rates, improvements to tax processes and utilization of technology, integration with business groups, the early indication of non-routine transactions, and influencing tax policy. In addition, participants expect to have slightly more dealings with tax authorities.

More than half of respondents currently have disputes with tax authorities. Most of these controversies refer to federal corporate income tax, transfer pricing, indirect taxes and local income tax.

Time spent by the tax function: Actual versus planned

Most respondents wish to spend their tax department's time on value-adding activities rather than on tax reporting and compliance.



Glossary

BEPS	Base Erosion and Profit Shifting
CEO	Chief Executive Officer
CFO	Chief Financial Officer
EBIT	Earnings before interest and tax
EBITDA	Earnings before interest, tax, depreciation and amortization
ERP	Enterprise resource planning
FTE	Full time equivalents
HR	Human Resources
IT	Information technology
KPI	Key Performance Indicator
OECD	Organisation for Economic Cooperation and Development

Clarity on

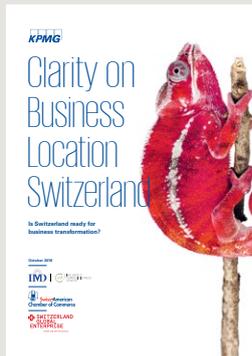
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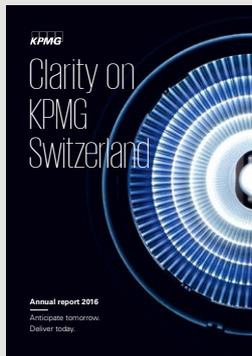
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