



# Getting down to business with indirect tax

**A four-part series exploring some of the most challenging technical and policy issues facing global leaders of indirect tax.**

KPMG International

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# Introduction

Value added taxes (VAT) are spreading, and the scope of current regimes is expanding. Tax authorities are looking more closely at indirect tax, and they're applying technology with increasing sophistication for enforcement. Financial and reputational risk related to indirect tax are rising in step. In this environment, today's indirect tax leaders face a world of uncertainty. Chief among their questions are:

- Are there opportunities for the tax team's transfer pricing, VAT and customs specialists to integrate their company's approach to changes in international taxation and generate more ideas, efficiencies and value?
- How can businesses define effective performance metrics that drive tangible improvement in global indirect tax management?
- How can indirect tax teams do more than react to the indirect tax developments by building capabilities to predict, assess, manage and influence dynamic regulatory change?
- How do indirect tax executives guarantee their functions are designed to meet today's demands and the challenges of the future?

In this publication, you'll find clear, practical answers to these questions and more. This set of articles from the series *Getting down to business with indirect tax* are based on ideas and solutions discussed by indirect tax executives attending KPMG International's 2016 KPMG Global Indirect Tax Forum in Barcelona, together with senior indirect tax professionals with the member firms of KPMG International worldwide.

Collectively, the articles in these pages show how a transformative approach to aspects of indirect tax compliance can deliver efficiencies, reduce risk and improve cash flow. In short, you'll learn how getting down to business with indirect tax can up the profile of indirect tax leaders as strategic advisors who boost their organization's value.

Looking ahead, more indirect tax changes are set to reshape the landscape. These include:

- a new nationwide GST system set to replace a host of existing indirect taxes in India as of 1 July 2017
- a harmonized VAT system being introduced in 2018 by members of the Gulf Cooperation Council (Saudi Arabia, Qatar, Oman, United Arab Emirates, Bahrain and Kuwait)
- a sweeping review aimed at modernizing the European Union's VAT system, as called for in the EU's 2016 VAT Action Plan
- uncertain impacts on cross-border commerce arising from the UK's pending exit from the EU and the new US administration's stance toward trade.

To learn more about the indirect tax outlook for 2017 beyond, please visit [kpmg.com/indirecttaxoutlook2017](http://kpmg.com/indirecttaxoutlook2017).

# Key performance indicators driving indirect tax value

Most global companies keep a close eye on metrics like the effective tax rate to monitor their performance on income taxes. But only a minority of them give the same attention to how they're performing where indirect taxes are concerned — which is a surprise given the huge amounts of working capital tied up in indirect tax processes. With tax authorities increasingly shifting their focus to consumption taxes like VAT, businesses are becoming more aware of the need to manage risk and ensure that they have robust indirect tax processes in place. However, even faced with these challenges, many indirect tax teams may be missing opportunities to prove their value and make the case for investment to improve cash flow, reduce costs, upgrade business processes and manage this risk.

# Shift toward indirect taxes continues

Current trends suggest that the impact of indirect taxes will continue to increase. As competition for foreign investment intensifies, many countries are reducing their headline corporate tax rates and offering generous income tax incentives for intellectual property development and innovation. To replace revenues from taxes on profits, most countries are shifting their reliance to taxes on consumption and realizing the benefits of indirect taxes in delivering stable, sustainable and near real-time sources of tax revenue. Once India, China and the Gulf states have their value added taxes/goods and services taxes (VAT/GST) in place, over 160 countries (except the US) will have centrally administered indirect tax systems.

As part of this global shift, tax authorities are putting more priority on ensuring collections are thorough and complete, and they are investing heavily in electronic processes for collecting, analyzing and benchmarking taxpayers' indirect tax accounts and transactional data. Tax authorities are looking not only for accurate, timely filings but also for indications that organizations have effective management and governance in place.

With the coming wave of tax changes resulting from the global project to address tax base erosion and profit shifting, many companies are working to contribute to tax policy development so the needs of business are taken into account (see related article by KPMG Global Indirect Tax Services, *Don't underestimate BEPS' impact on indirect tax*<sup>1</sup>).

# Income taxes remain top priority

While KPMG International research<sup>2</sup> shows this shift toward indirect taxation has been going on for more than a decade, most organizations have kept their traditional focus on the hard costs associated with income taxes. Effective tax rate is a widely used and recognized metric that is simple to calculate and benchmark against peers.

Few companies have set equivalent metrics for indirect taxes. In response to a KPMG survey,<sup>3</sup> only 25 percent of companies say their company has specific indirect tax metrics. Most of these measures relate to basic compliance, rather than activities that could improve the bottom line and drive cash flow improvement. Given that indirect tax involves the third largest cash flow of organizations (after sales and cost of sales), then senior management appear to lack visibility over the movement of large sums of money in and

out of the business and assurance that they are being well managed. In this regard it is important to appreciate that we are not looking at the net payable or receivable with the tax authority but the gross indirect tax flows; that is VAT included in payments to vendors and receipts from customers.

Of those companies that do have metrics, the top two measures — timely and accurate submission of indirect tax returns and minimization of interest and penalties — are unlikely to affect the company's cash position. The third most important metric, rated by only 14 percent of respondents, is managing indirect tax cash flow, which is arguably the only one of the top three that could generate value for the organization by improving working capital.

<sup>1</sup> Don't underestimate BEPS' impact on indirect tax, KPMG International, 2016

<sup>2</sup> 2015 Global Tax Rate Survey, KPMG International, 2015

<sup>3</sup> 2015 Global Benchmark Survey on Indirect Tax and Trade Compliance, KPMG International, 2015

## Breaking the vicious cycle

Without clear, commonly understood key performance indicators (KPI), indirect tax teams have a hard time measuring and demonstrating their worth and making a case for investment in new technologies and process efficiencies to derive value from indirect tax processes. Furthermore, indirect tax teams often struggle to effectively embed and execute controls to manage the risks associated with VAT. And without investment, a vicious cycle is created as indirect tax teams are unable to pursue opportunities to reduce costs, manage risk and add value.

Companies tend to allocate investment based on an expected return. Many chief financial officers, heads of shared service centers, and even some heads of tax have little knowledge of indirect tax matters, let alone the value it can bring or the risk that such a large throughput inherently carries. Clear measures and targets make it possible to quantify the value indirect tax teams bring and to succinctly communicate to stakeholders the added value that a certain amount of investment could produce.

## Delivering against stakeholders' priorities — what matters most?

Thus the most powerful KPIs look beyond the indirect tax function to address what matters most to the organization and each of the indirect tax function's stakeholders. These KPIs are designed to deliver against stakeholders' priorities and to communicate how the indirect tax function can help drive the objectives that its stakeholders are measured by and are trying to achieve.

This approach involves identifying the KPIs of the organization, finance function and other business partners and determining where indirect tax can make a direct impact, recognizing that different stakeholders have different goals and needs.

For example, CFOs are motivated to improve the operating cash flow and may be inclined to invest in indirect tax people, processes and technologies that are projected to produce a quantifiable amount of cash flow savings.

By contrast, heads of shared service centers (SSC) are often under pressure to reduce costs. They may respond well to a pitch, for example, that a certain amount invested in indirect tax technology and automation could reduce the SSC's head count by a certain percent. The trick lies in identifying a small set of fundamental KPIs that can show results that are compelling to a range of stakeholders.

KPIs for indirect tax will vary by industry. Different industries may at different times place an emphasis on certain matters over others. For example, financial services companies, which are often VAT-exempt and so unable to recover indirect taxes paid, are likely to focus on measuring cost reductions in the first instance. Companies in other sectors will be more interested in indicators that show the value of compliance efficiencies and improved recoveries through indirect tax planning.



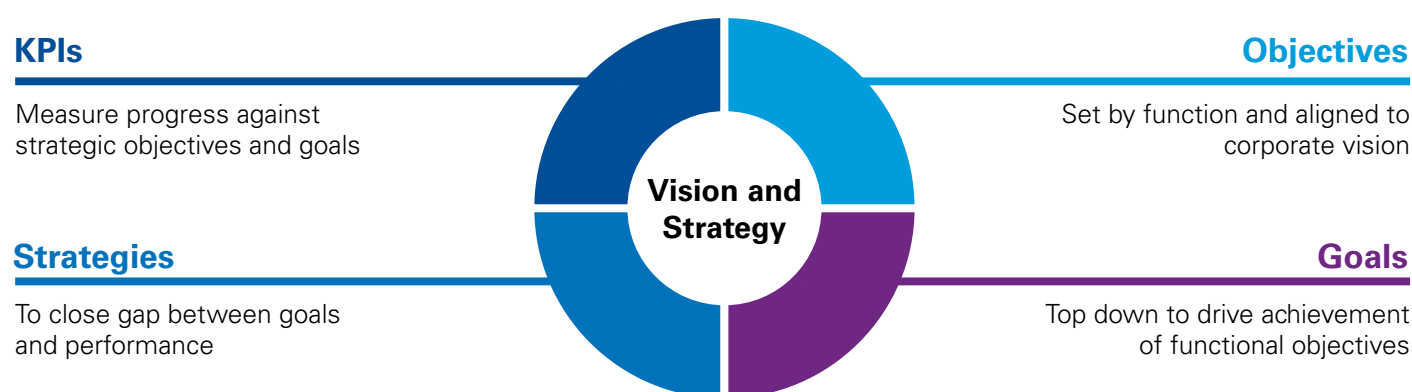
# Quality versus quantity — focus on what's 'key'

Indirect tax executives should strive to develop five or six performance indicators that line up with what the organization aims to achieve and show how the indirect tax team is supporting those aims. Having too many KPIs can cloud the bigger picture and lead to box-ticking instead of monitoring performance fundamentals and highlighting the dividends of change. A strong set of KPIs will focus on:

1. value and risk
2. efficiency and effectiveness
3. qualitative and quantitative measures.

The methodology that follows shows step-by-step how indirect tax teams can demonstrate the value they bring to the organization and build their case for investing in people, processes and technology. This methodology is based on the successes of indirect tax professionals with KPMG member firms worldwide in helping international companies developing performance evaluation systems for their indirect tax functions.

## Defining KPIs: the strategic planning methodology



Source: KPMG International, 2016

# Defining KPIs: the strategic planning methodology (cont.)

- 1. Review vision and strategy:** Start by examining the overall vision and strategy of your organization and function (e.g. finance) and how your indirect tax function can support them. What aspirations are driving your indirect tax team's performance? For example, your team's vision might strive to be 'brilliant at the basics' on one hand while delivering 'strategic value' to the organization on the other.
- 2. Identify objectives:** The next step is to identify the functional levers that can directly affect the indirect tax team's ability to achieve or support the achievement of this vision. What objectives would bring you closer, for example, to being "brilliant at the basics"? Appropriate objectives could be:
  - running an efficient, cost-effective indirect tax function
  - paying the right amount of tax on time
  - meeting group and statutory requirements
  - being an effective business partner.Objectives that could boost your team's delivery of strategic value might include:
  - optimizing indirect tax cash flow
  - minimizing irrecoverable indirect tax across the global business
  - managing indirect tax risk across business processes
  - influencing and contributing to indirect tax policy.
- 3. Goals:** For each objective identified, you can then outline how the objective would be achieved. In order to run an efficient, cost-effective tax department, for example, a goal could be to maximize the efficiency of the indirect tax return preparation process. In order to influence and contribute to indirect tax policy, a goal could be to increase participation in the work of industry associations and working groups.
- 4. KPIs, targets and strategies for achieving them:** The final steps involve setting KPIs with clear targets that will allow you to assess progress toward achieving specific goals. As an objective measure of your organization's efficiency in preparing indirect tax returns, the KPI could look to the number of returns prepared per full-time employee (FTE) currently and set an aspirational target for increasing that number by a certain amount (e.g. 14 per FTE). A more qualitative example is to build sustainable relationships with stakeholder in a coordinated fashion through KPIs that would look at measures such as successful execution of an indirect tax communications plan. Of course, setting KPIs won't generate value on its own. You'll also need to identify a strategy that bridges the current and target states and provides a road map for realizing each KPI's target. A strategy for improving the productivity of indirect tax return preparers could involve increased use of technology for indirect tax processes. Increased technology use could also form part of a strategy for influencing indirect tax policy, by freeing time that would otherwise be spent on compliance for more strategic work.



# Mix qualitative and quantitative measures for a better view

Having a mix of qualitative and quantitative metrics is important for achieving a well-rounded view of an indirect tax function's performance. Quantitative measures provide a concrete, objective means of determining base levels and setting clear targets. For example, the value of the efficiencies in indirect tax return preparation can be quantified in terms of wages saved as a result of the FTEs' greater productivity or cash savings identified.

Qualitative measures round out the picture by enabling more subjective evaluation of indirect tax activities. For example,

net promoter scoring could be used to gain internal customer feedback on the indirect tax team's effectiveness as a business partner, and polling committee chairs and members through interviews and questionnaires can help evaluate the impact of efforts to influence government policy.

Regardless of the nature of the KPI (i.e. qualitative or quantitative) it is important to strive for hard targets around softer goals which may be slightly less structured to ensure the ability to show progress.

# Monitoring, analysis and continuous improvement

In addition to identifying your KPIs, you need to build a process for collecting data, assessing your progress against them, and evaluating your KPIs' effectiveness in producing useful information and driving better performance. KPIs can quickly become meaningless without a strict governance policy for monitoring, analyzing and improving them. KPIs should be reviewed and updated regularly as the business, economic and regulatory environment and other variables change.

Consider engaging third-party advisors to help guide your KPI-setting process. If you are at the beginning of the process, external advisors can help you review what measures are in place and define what measures are needed to track progress toward achieving objectives, and suggest generic KPIs and leading practices specific to your industry that can be tailored to your activities. If your indirect tax organization already has performance measures in place,

third-party advisors can help you assess whether refined or new KPIs could present a clearer view of what's working well, where improvements are needed, and whether additional investment could reduce costs or add value.

Many organizations are only just beginning to set a framework to derive real performance improvement in global indirect tax management. Measurement drives performance and informs leadership of the effectiveness of the indirect tax function. Realizing these benefits in practice requires a clear focus on the most critical KPIs and how they can be improved within the business over time.

By engaging widely within the organization to identify key business objectives and future direction and by helping the organization deliver on its goals, indirect tax teams will have a stronger voice in strategic decision making and build their profile as valued business partners.

# Taxing complex global supply chains in a post-BEPS world

The global project to address base erosion and profit shifting (BEPS) is primarily directed at taxing international profits, causing few companies to examine the potential impact of BEPS changes on companies' indirect tax positions in detail. But for global companies with complex supply chains and high volumes of transactions, the interlocking implications of BEPS for transfer pricing, value added taxes (VAT) and customs will be substantial.

In fact, the need to manage the impact of the anti-BEPS proposals across the company's supply chain can provide the impetus to drive interaction and collaboration among these three often-isolated disciplines. Starting from the premise that intercompany pricing is: 1) a major element in managing transfer pricing policy, 2) used to calculate import duties and 3) the basis for indirect tax calculations, analyzing and planning the company's responses to BEPS in concert, stands to generate more ideas, efficiencies and value than are likely to be produced when transfer pricing is considered on its own. The resulting collaboration and integration of a company's, transfer pricing, VAT and customs teams could continue producing benefits for the company for years to come.

# Transfer pricing, indirect tax and customs rules in flux

As governments work to implement the BEPS proposals, all forms of taxation will be affected. For corporate taxes, the key outcome of the process will be to consolidate and widen the tax base as well as to increase disclosure and reporting obligations.

Transfer pricing is a special focus of the Organisation for Economic Co-operation and Development's (OECD) Action Plan on BEPS. The proposals attempt to recalibrate transfer pricing principles to better allocate profits among locations where economic activity is carried out and where value is created. Country-by-country reporting and enhanced transfer pricing documentation rules require companies to collect more extensive data and make more detailed disclosures.

Meanwhile, as the BEPS project progresses, the widespread adoption of VATs and goods and services taxes (GST) continues. Malaysia and the Bahamas have both introduced VAT in the last couple of years. China has expanded its VAT rollout to cover industries not already included, India is looking to replace most of its indirect taxes with a GST, and the Gulf States are well advanced in their plans to introduce a common VAT in the region. Except for the United States, the global adoption of VAT will effectively be complete by 2018.

With new systems, changing VAT rates and bases, and rising tax authority scrutiny of VAT transactions worldwide, businesses need to process ever more data to ensure they collect and pay the right amounts of indirect tax on all their purchases and sales wherever they operate.

Customs regulations and procedures are also undergoing change at a rapid pace. New free trade agreements continue to be negotiated and fiercely debated. The European Commission's Union Customs Code (UCC), which took force on 1 May 2016, completely redesigned the customs environment for EU member states. The UCC's new rules and procedures — and its aim to shift to a paperless, fully electronic and interoperable customs environment — has wide-ranging consequences for international supply chains and high transaction volumes.

In addition, the UK's impending withdrawal from the European Union as a result of the Brexit referendum will likely have dramatic implications on customs, transfer pricing and indirect tax for essentially all multinationals doing business in Europe.

## How will BEPS affect indirect taxes and customs?

While one of BEPS' primary goals is to address aggressive transfer pricing, which many believe is used by multinational companies to avoid paying their "fair share" of taxes, its impact will be felt beyond the transfer pricing landscape. For indirect taxes, the most immediate impact of BEPS will stem from the OECD proposals to address transactions in the digital domain. The proposals would change the charging structure for VAT on services and intangibles by requiring a business selling to consumers in another jurisdiction to collect and pay VAT in the consumer's country, rather than their own. These proposals aim to prevent companies from reducing their VAT bills by locating sales operations in low-rate jurisdictions. Expanded concepts of permanent establishment might also trigger new VAT obligations. Many companies may need to register for VAT and meet VAT reporting obligations in more jurisdictions as a result. These changes will also then impact indirect taxes on tangible good transactions. (For a more detailed discussion, see a related article from KPMG's Global Indirect Tax Services, "Don't underestimate BEPS' impact on indirect tax").

From a customs perspective, the impact will stem primarily from two elements. First there will be greater transparency of company activities and information to the tax authorities as a result of the new reporting requirements under BEPS. As such, importers should be prepared for increased transparency under the BEPS reporting standards to highlight customs related party pricing issues.

Second, there will be customs implications as companies assess and change their business structures in ways that impact compliance with customs import valuation laws. Some of these include: changes in agent and commissionaire structures, insertion of a foreign related middleman, shifting of intellectual property, including changes on where it's performed, who owns it and hows it's paid. For a more detailed discussion, see a related article written by KPMG member firm professionals from Journal of International Taxation called *BEPS from a Customs Perspective*.<sup>4</sup>

<sup>4</sup> <http://www.kpmg-institutes.com/content/dam/kpmg/taxwatch/pdf/2016/beps-and-customs-join-0716.pdf>

# Domino effect of intercompany pricing

As countries bring their transfer pricing rules in line with the anti-BEPS proposals and tax authorities gain more information about and devote more resources to transfer pricing issues, companies can expect to see their transfer prices come under more frequent challenges. Add to that the fact that more information may be shared with customs authorities for auditing purposes, the consequences of adjustments to transfer prices across the supply chain pose considerable uncertainty and risk.

## Case Study

For example, consider a global manufacturing company that ships goods from Spain (ES) to its subsidiary distributor in Mexico (MX).

### Legacy Transfer Pricing

ES (HQ) → MX (Sub) → considered limited risk  
— Resulting in a specific profit target for MX

### Post BEPS Transfer Pricing

ES (HQ) → MX (Sub) → No longer limited risk (distributor)  
— Requiring higher profit targets in MX

### Impact:

- EU-MX FTA eligibility or local content percentage goes down (when transaction value is used for calculation)
- Certain products may no longer be eligible for zero-reduced import duty payments
- Increase in import VAT payments impacting the overall value of the goods and subsequent cash flow.

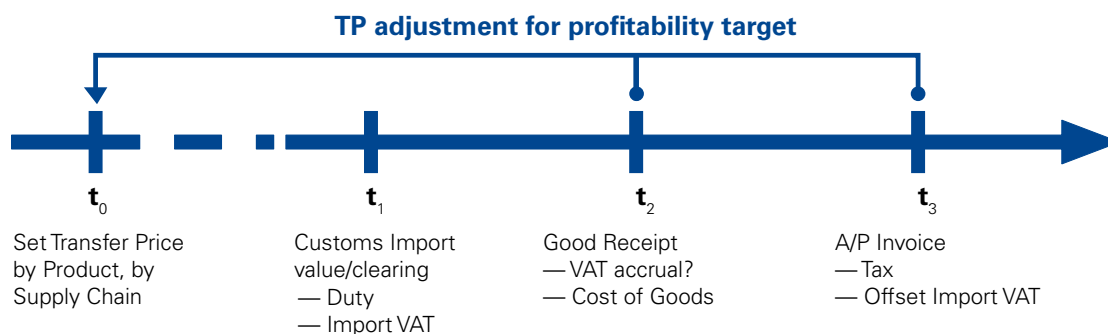
Although intercompany prices were actually reduced as a result of BEPS driven change, this change unexpectedly triggered negative outcomes for customs and indirect tax and resulted in an unnecessary loss for the company as a whole, which could have been avoided with better planning.

Although a transfer pricing adjustment may trigger an adjustment to the (factual and commercial) consideration paid in that transaction, countries treat transfer pricing adjustments differently. Monitoring and following these inconsistent approaches can be difficult. Some jurisdictions consider transfer pricing adjustments as VAT-relevant adjustments to the prices agreed between the parties. Others may disregard transfer pricing adjustments if only the corporate tax returns were amended (not the commercial pricing) and no actual payment was made.

In turn, transfer pricing and VAT adjustments may have a number of knock-on effects:

- Taxpayers would need to disclose the amendment either on an amended VAT return for the period of the original payment or in the period of the adjustment.
- New invoices or credit/debit notes would be needed to reflect the adjustment.
- Adjustments impacting imported or exported tangible goods would need to be disclosed to tax authorities.
- Correlative transfer pricing adjustments to, for example, interest, dividends and services may create additional VAT issues.
- Changes relating to intellectual property valuation could affect custom valuations and thus any import VAT paid.

Also bear in mind that customs authorities scrutinize the value of related-party transactions more closely than transactions between unrelated parties. Like transfer prices, values for related-party transactions for customs purposes are expected to meet customs own set of arm's length rules<sup>5</sup> and red flags are raised when they don't. As transfer pricing adjustments are typically retroactive, managing the ripple effects through amended VAT returns, customs declarations and invoices can complicate the company's compliance burden, impede recoveries and cash flows, and create unnecessary extra costs.



Source: KPMG International, 2016

<sup>5</sup> Tests used to validate the acceptability of prices in related party transactions may differ significantly to those used for transfer pricing purposes.

# Organizational barriers block cooperation

Despite the interplay between transfer prices, indirect tax and customs, a number of factors work to discourage cross-functional collaboration:

- The three disciplines are highly specialized, with different terminologies and perspectives, even in respect of the same subject matter.
- Reporting lines can differ, for example, with transfer pricing teams reporting through to tax while customs and VAT teams reporting to logistics and finance, respectively.
- Each team often relies on independent data streams and people, and even though their information needs

sometimes overlap, data management systems and processes are often separate.

- Formal processes for communication among the three groups are rarely in place, and there is little recognition that communication is even needed.

Nevertheless, all three disciplines are greatly impacted by intercompany prices and share common goals: to ensure accurate compliance, to generate accurate documentation for compliance and audit, and to identify opportunities to reduce costs and add value. A more integrated approach to meeting these goals can help reduce costs, mitigate risk and identify opportunities for each discipline to drive more value.

## Connecting the dots

While BEPS will have unforeseen impact over customs and indirect tax, it could also be used as a catalyst for better processes around intercompany price setting.

As a first step toward a more holistic approach, each team needs to develop a better awareness of the needs and objectives of the three disciplines and how they are interconnected. This common understanding will lay the foundation for a more collaborative working environment.

One way to build greater mutual understanding is for members of three groups to analyze the 'trigger points' of

each discipline across the company's supply chain. Trigger points are those 'day to day' critical facts, events, data and policies in the value chain of one discipline that could give rise to potential compliance and operational impact within another discipline. Some may be obvious, for instance retroactive transfer pricing adjustments will have a direct impact on import value and indirect tax payments of tangible goods, and others not so much, such as the impact of shipment incoterms and existence of bone fide sale for indirect tax obligations. Common trigger points for transfer pricing, customs and indirect tax are as follows.

Transfer pricing	Customs	Indirect tax
Method/desired profit benchmark	Customs value	VAT calculations
Cost of goods sold	Classification	Registration
Profit results	Duty payments	Invoicing
Royalties/licensing	Free trade agreements	Cash flow
Retroactive adjustments	International commercial terms	Reporting
Function and risk	Circumstances of sale	VAT grouping
Permanent establishment	Importer/exporter of record	Title transfer
Tax structure	Country of export and import	Formalities
Value chain	Bona fide sale	Vendor contracts
Commissionaire structures	Import/export declarations (documentation)	
	Product descriptions	
	Exchange rate	

Source: KPMG International, 2016

Having determined the trigger points for each discipline, the next step is to analyze each trigger in terms of its impact and actions required by asking these questions:

- Is the trigger point's impact internal or external?
- Does it affect the balance sheet or P&L?
- Is there an associated reporting obligation?
- Is it applicable locally, regionally or globally?
- Is it driven by regulatory requirements or operational necessity?
- Which parts of the value chain does it affect: business strategy, business development, buying, selling, processes and/or inventory?

An important element of this exercise entails a detailed, cross-functional analysis of the company's information flows.

Questions to ask include:

- What data elements are required for each discipline?
- Are these data points currently collected and reported separately?
- Are there opportunities to set up common data gathering systems to feed the required data to each function's compliance?
- Are there opportunities to leverage this data through analytics for use in making strategic decisions?

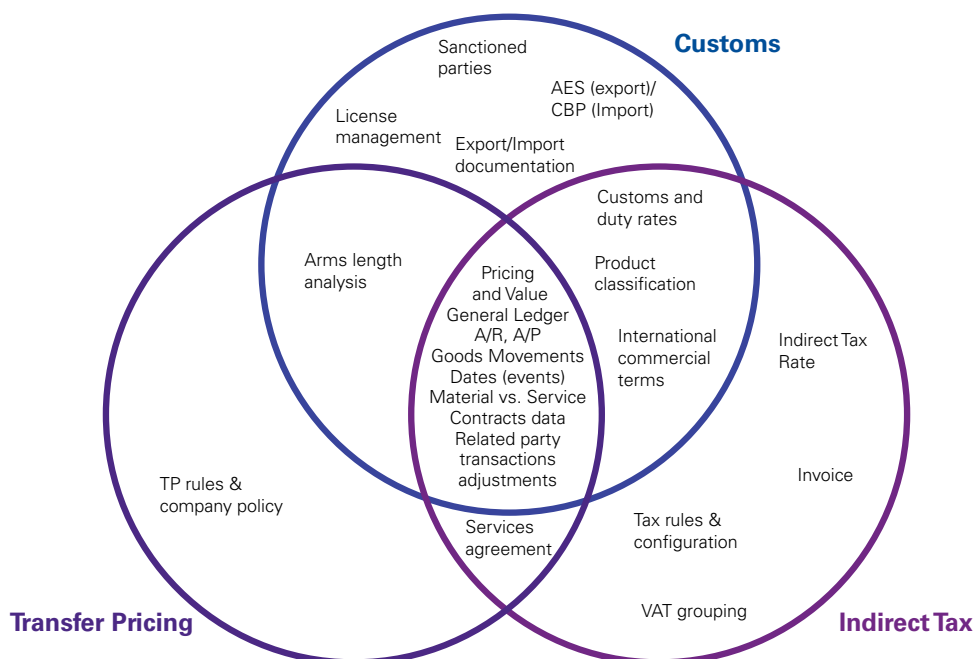
As with trigger points, an integrated analysis of data elements, sources and uses can point the way to more streamlined processes and systems for gathering, extracting and mining common data elements.

Once the teams have connected all the dots, they can begin to build their business case for investments that bring people, processes and systems together to meet each function's needs while generating efficiencies and value for the business overall.

## Common data, different uses

Customs, transfer pricing and indirect tax functions all extract and utilize data for compliance and various forms of analytics. On initial review, the data each function gathers is very similar with a lot of overlap — as indicated by the VENN diagram below. Yet more often than not, data strategies are not integrated among the three functions.

The interdependence of data highlights the need for a common strategy across the various function facilitating faster and more efficient consumption.





# Benefits of collective, forward-looking planning

Proactively managing the interaction of indirect taxes, customs duties, and transfer pricing in supply chains is key to maximizing efficiency and reducing cost, particularly in an era of value-driven tax management. Leveraging mutual understanding and available data across the supply chain can help ensure compliance, manage risk and unlock tax and non-tax value for the organization. As illustrated by the previous example, the cost of non-coordination is more than simple inefficiency and can add up to actual above the line costs.

The benefits of collective, forward-looking planning for transfer pricing, indirect tax and customs teams include:

- reduced risk
- less duplication and overlap of activities and processes among the three disciplines
- real-time communication of pricing and valuation adjustments
- greater efficiency and improved compliance

- improved cash flow planning
- more consistent platforms for data collection and analytics
- improved ability to influence outcomes
- heightened profile for all teams as strategic business partners.

Going back to our example, had the decision to change intercompany pricing been evaluated from all perspectives, the company could have found a way to change its prices in such a way as to not impact its preferential agreement eligibility.

What if the domino effect of intercompany pricing could be handled through an integrated cross functional technology solution for transfer pricing, customs and indirect tax?

There is a vision. Stay tuned...

# Designing an indirect tax function that's fit for the future

For today's indirect tax leaders, the pace of change is quickening and complexity continues to escalate. Amid finance function transformations, evolving regulation, and rising tax audit pressure, indirect tax teams must manage huge volumes of data and reporting obligations from multiple sources and stakeholders to ensure compliance and, increasingly, to contribute strategic value. How can indirect tax executives guarantee that their functions are designed to meet today's demands and the challenges of the future?

Based on the work of leading global companies, designing a tax function that's fit for purpose starts with a detailed examination of your indirect tax operating model — how it's governed, who's responsible for what, how risks and data are managed, and how people, processes and technology are deployed. The first steps are to assess each of the model's parts to see where you are today, and where you want to be tomorrow. The next step is to define the appropriate investments in people, processes and technology that you'll need to bridge the gaps between your current and future states. Based on this analysis, you can chart your path toward an indirect tax function that's built for success in the years to come.

# Managing a world of change — inside and out

An array of internal and external forces is shaping the blueprints for tomorrow's ideal tax functions. Chief among these factors are ongoing changes in the following areas.

**Evolving finance functions:** Most of the world's global companies are continuing to look to reduce the cost of finance operations, whether through outsourcing, co-sourcing or shared service center models. The greater automation and standardization that come with centralization aim to reduce costs and improve processes. Inevitably, as local finance capability disappears, the delivery of indirect tax compliance needs to be reassessed through a similar lens. But as the ability to tap the local knowledge and tax authority relationships becomes more remote, indirect tax executives are challenged to develop new ways to establish confidence that their compliance obligations are well managed in all locations.

**Evolving tax authorities:** The world's tax authorities are moving quickly to take advantage of new technologies and data analytic techniques to enforce compliance. As tax authorities adopt increasingly sophisticated data-driven techniques to assess risk and target audits, companies are expected to provide digital tax filings and electronic data in a rising number of tax jurisdictions, but in a range of differing, localized electronic formats. The introduction of macro level country-by-country tax reporting coupled with OECD prescribed, transaction level SAF-T like reporting is presenting immediate challenges in managing information flows. With expectations that periodic tax reporting will be replaced by real-time reporting over the next decade, businesses need better, more reliable processes for generating immediate tax information, and efficient data management is becoming even more complex.

**Evolving skill sets:** Advances in technologies such as robotics, artificial intelligence and machine learning are changing necessary skill sets and will transform how finance function activities such as Accounts Payable are conducted.

Future indirect tax executives will have less need for the depth of technical indirect tax knowledge they required in the past. Increasingly intelligent software will not only be able to interpret and apply indirect tax rules across the world's regimes, it will also be able to adapt its understanding, for example, in response to new court decisions or legislative change. Indirect tax executives will need to bring a more strategic, evaluative understanding to the functional risks and opportunities that technology and data analytics will enable both in the tax function as well as wider finance function.

**Evolving accountabilities:** As the amounts of tax paid by large corporations have come under increasing scrutiny, indirect tax executives are being called on to answer questions about their companies' indirect tax positions by senior management, boards and a range of external stakeholders, including investors, the media and the public. A rising number of tax authorities are inquiring into companies' tax governance and strategies as part of their assessment of tax compliance risk. At the same time, indirect tax executives are increasingly expected to recognize strategic opportunities and pursue them in partnership with the business. Along with new technology-related skills, indirect tax executives will need to develop their abilities in cognitive areas like communication, negotiation and change management.

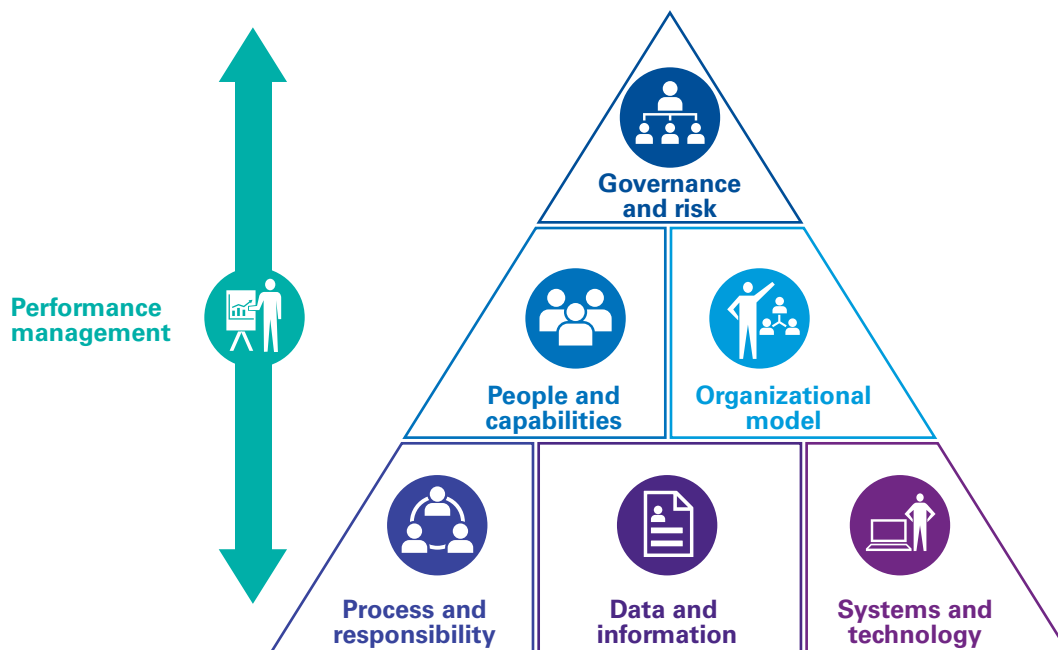
Overlying all of these driving forces is the continuing spread of indirect taxes, as the vast majority of countries in the world (except the United States) have or plan to establish indirect tax systems and as indirect tax bases of current regimes continue to broaden.

There is no doubt that indirect tax functions of the future will look significantly different than they do today. But for indirect tax executives struggling with the day-to-day challenges of meeting their current responsibilities, determining their function's future design is a daunting task.

# The indirect tax operating model: assessing the key components

Indirect tax professionals with KPMG's member firms recommend a measured approach that breaks the design process into manageable components based on the key elements of an indirect tax function's operating model.

By defining the current and desired future state of each of these elements, the steps you need to take to reach that future state start to become clear.



Source: KPMG International, 2016

The components of the indirect tax operating model include three strategic components and three enabling components:

— **Strategic components**

1. Governance and risk
2. People and capabilities
3. Organizational model

— **Enabling components**

4. Process and responsibility
5. Data and information
6. Systems and technology

— These six operating model components are discussed in more detail on pages 3 and 4. The seventh component — performance management — involves setting clear key performance indicators (KPI) to measure and demonstrate the value contributed through an indirect tax function's operating model. For details on this component, read the companion article in this series, [Key performance indicators driving indirect tax value](#).

# Charting your course for the ideal future state

The operating model's components should work together to create an indirect tax management structure that delivers a single, clear view of performance, a strategic platform for making business decisions, comprehensive and efficient compliance processes — and above all, peace of mind that these objectives are being met.

## 1. Governance and risk

This operating model component involves the oversight required to direct the tax function and the enabling culture (behaviors and values) required to deliver the operating model. It also includes the key tax risks, mitigating factors and tax control framework. For this component, an ideal future state might be characterized by:

- a documented tax policy and risk management framework
- an organization-wide view of indirect tax as a key business partner
- controls embedded and monitored across business processes.

Barriers to achieving these ideals may include difficulties in gaining management buy-in and engagement, engaging with stakeholders in the business on defining controls that are suitably proportionate to levels of tax risk, and dealing with ongoing regulatory and business model changes. However, the development of metrics to support responsibilities and accountabilities can fuel better discussions and engagement with senior management. In addition, regulatory change can serve as a catalyst for transformation by providing a business case for investments in people, processes and technologies.

## 2. People and capabilities

What employee profiles are needed to deliver the operational model in terms of skills, capabilities and training needs, retention and engagement strategies, and succession planning? Ideally, the indirect tax function of the future would:

- assess resource requirements against both short- and long-term needs
- leverage resources and specialized capabilities from other functions where possible
- set clear career development paths for all indirect tax function roles.

As the role of indirect tax executives changes from technical expert to data scientist and business partner, their skills and the skills of the teams that support them need to evolve. Upgrading the function's mix of resources and skills can

improve career opportunities and boost retention. It can also encourage more movement of people with tax, finance and analytic skills between the indirect tax function and the business, improving the organization's store of knowledge of indirect tax and how it creates value.

## 3. Organizational model

The indirect tax function's number of full-time employees, their roles and reporting lines, and the global sourcing and location strategy comprise its organizational model. Leading practices in this area would see:

- the function's organizational model aligned with the broader tax function strategy
- clearly defined roles and responsibilities
- centralized finance functions (global business services, shared service centers) used to put in place end-to-end tax processes.

Achieving this ideal state often involves resolving conflicts between global versus local accountabilities. It also entails promoting more awareness and visibility of the indirect tax function's needs and value-driving potential across the tax department and the wider business. Once achieved, global versus local conflicts can be erased, gaps in accountabilities can be closed, and opportunities can arise to embed other resources in the organizational model, for example, through business partnering and internal audit.

## 4. Process and responsibility

Closely linked to the strategic component of governance and risk, this enabling component incorporates the key processes needed to deliver the tax operating model, including ownership and governance, operational responsibilities, and policies. It also encompasses the processes that drive efficiencies in practice, cost and levels of service. In an ideal future state, process and responsibility might include:

- standardized global tax processes with clear and commonly understood responsibilities and accountabilities
- comprehensive process documentation
- tax function activities focused primarily on adding value.

The lack of a board-approved governance framework or a scarcity of resources to deal with business and system change can impede efforts to enable these capabilities. But success on this component can produce direct benefits in risk management, efficiency and cash flow.

Embedding indirect tax within the business can open opportunities to push routine work down to other parts of the business and free indirect tax resources for higher-value strategic activities. Improved data quality and documentation can also promote better relationships with tax authorities by instilling confidence in your ability to get the numbers right.

## 5. Data and information

This component of the operating model comprises the governance of data, information ownership and quality; the effective, efficiency of delivery of data to the business; and the use of information to support decision making. Leading practices in this area would see:

- reliable data collected only once
- tax controls built into master data processes directly
- one, tax-sensitized chart of accounts.

Advancing to this state can be frustrated by the lack of standardized data formats, multiple data owners and processes operating in parallel, and poor management of master data. Enhancing data quality can drive better risk management and efficiency, while increasing centralization can vastly improve and streamline data management. In turn, the improved access to and visibility of data allows indirect tax teams to identify problems earlier, increase levels of automation, leverage solutions across the organization more broadly, and add value by contributing higher quality data and analysis to support business decisions.

## 6. Systems and technology

This component includes the core financial accounting platform, together with other systems that provide the required data to deliver tax processes; dedicated tax technology; and the infrastructure architecture and support model. In an ideal future, the indirect tax function's systems and technology supports would include:

- a global tax technology strategy and roadmap to improve automation and control as finance systems evolve
- automation of key tax calculation and tax reporting processes
- a tax data warehouse as a single source of tax reporting data, and the deployment of workflow technology.

As with the other two enabling components, systems and technology improvements are key for driving automation, standardization, control and efficiency, and for enabling tax issues to be managed proactively. However, indirect tax leaders often have little control of or input into their company's technological changes. By defining your indirect tax function's gaps and articulating the potential benefits of bridging them, indirect tax executives can make a solid business case for engaging in business transformation decisions to ensure indirect tax is aligned with wider enterprise IT initiatives.

## Leading practices — is your indirect tax operating model fit for the future?

<b>Governance and risk</b>	<b>Board approved and documented tax policy and risk management framework.</b>
<b>People and capabilities</b>	<b>Clear career development paths and training program available.</b>
<b>Organizational model</b>	<b>Organizational model designed to take into account tax strategy, risk and business needs.</b>
<b>Process and responsibility</b>	<b>Standardized and documented global processes with clearly defined responsibilities.</b>
<b>Data and information</b>	<b>No re-work of data required and data can be relied upon by tax.</b>
<b>Systems and technology</b>	<b>High level of automation and range of tax technology implemented.</b>

Source: KPMG International, 2016



In summary, the dynamic business and regulatory environment will continue to present indirect tax functions with new and ever more difficult challenges. Responding to these pressures can open opportunities to shift your indirect tax function's focus from compliance to adding real economic value to your organization. While the path forward may seem unclear, taking a step-by-step approach that focuses on each operating model component in turn will get you well on your way to an indirect tax function design that's truly fit for the future.

# Surviving regulatory and policy change in indirect tax

Value-added taxes (VAT) are now in place in 160 jurisdictions, and many of these countries are increasing their reliance on VATs as a revenue source by increasing rates, broadening the tax base and enhancing audit and compliance functions. For international companies with large transaction volumes and high VAT throughput, managing indirect tax compliance amid rapid global regulatory change may seem overwhelming — but their company's profitability, or very survival, can depend on it.

Help is at hand. This article aims to show indirect tax leaders how they can deal with rapid regulatory change by putting in place a practical framework to predict, assess, manage and influence it.

# Complexity spirals as reliance on VATs rises

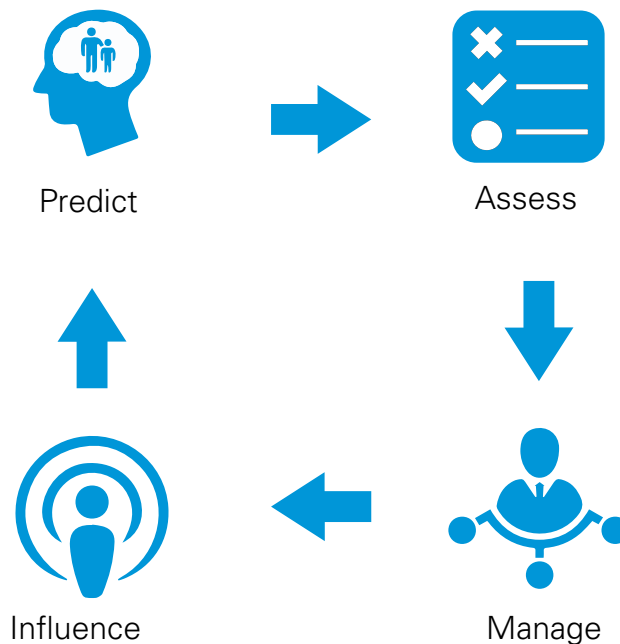
Taxes on general consumption raised an average of 20.2 percent of total tax revenue in member countries of the Organisation for Economic Co-operation and Development (OECD) in 2012 (compared to 11.9 percent in 1965). Of this amount, VAT accounted on average for 19.5 percent of total tax revenue.<sup>6</sup> As governments increase their reliance on VATs for higher proportions of revenue, a number of forces are at the same time increasing complexity and driving regulatory change:

- Tax authorities are enhancing the revenue-raising capacity of VATs by stepping up efforts to improve VAT compliance and combat fraud and avoidance.
- Growing global trade and rising cross-border flows of goods and services are significantly complicating indirect tax compliance.
- Advancing technologies and disruptive business models (e.g. UBER, Airbnb) are creating uncertainty over how existing VAT rules apply and whether governments will respond with regulatory change.
- International tax regimes worldwide are being amended as countries implement the recommendations arising from the OECD's Action Plan on Base Erosion and Profit Shifting (BEPS), with significant implications for VATs. Examples include: requirements for non-resident suppliers to account for VAT on supplies of e-services made into a country; changing concepts of permanent establishment, and; differing VAT registration thresholds (see the related article by KPMG's Global Indirect Tax Services, [Don't underestimate BEPS' impact on indirect tax](#)).
- In some jurisdictions, notably the European Union, the difficulty of amending VAT legislation creates uncertainty as emerging case law increasingly prevail over current law.

## Dealing with regulatory change: a practical framework

- Indirect tax regulations are rarely static, and, in light of the above forces, it seems likely that companies will be dealing with considerable regulatory flux for at least the next several years. In this reality, indirect tax managers cannot afford to fall behind or risk being blindsided. Based on experience helping companies worldwide cope with changing VAT and other laws, indirect tax professionals with KPMG's network of member firms advise taking a proactive approach by developing processes to enable four key activities:
  1. predicting regulatory change
  2. assessing the impacts
  3. managing the impacts
  4. influencing regulatory change.

<sup>6</sup> Organisation for Economic Co-operation and Development, Consumption Tax Trends 2014, at p. 9.



Source: KPMG International, 2016.

## 1. Predicting regulatory change

You don't need a crystal ball to predict some regulatory developments. Changes arising from case law, government consultations, fiscal regime changes and the activities of lobby groups usually come with some amount of warning and lead time. But other developments can occur at random, brought on by unpredictable events like media leaks, whistle-blowing, incidents of fraud and avoidance, changing trade flows and technological disruption.

Indirect tax leaders of international companies cannot possibly cover all the bases for predicting regulatory change. But you can take steps to ensure you are aware of pending change as early as possible.

One step is to ensure you understand and monitor the long-term triggers of regulatory change that are relevant to your business. These include policy statements by politicians and officials, tax court proceedings, trends in VAT law that are mimicked from country to country, and proposals on your particular industry's agenda.

A second step is to set up a network of 'spotters' and 'catchers'. 'Spotters' can include an internal group of indirect tax, finance and other professionals across the business who gather regularly to discuss what might be on the horizon and brainstorm potential responses. External spotters include professional advisers, lobby groups and industry associations, and your indirect tax peers in competing companies. 'Catchers' can be appointed to filter information and flag potential change as part of their specific role.

Building a strong bellwether network can vastly reduce the potential for surprises and give you more time to assess your response to change. As we'll see later in this article, this network will also be crucial to your ability to influence change before it occurs.

## 2. Assessing the impacts

Once potential or pending regulatory changes are identified, their potential impacts need to be assessed. Impacts should be assessed in both quantitative and qualitative terms:

- **Quantitative impacts** include effects on systems and compliance costs, margins and forecasts. This part of the evaluation should be led by the finance function, using financial modeling to capture and assess all impacts across the value chain.
- **Qualitative impacts** include effects on employees' work load, compliance risks (e.g. potential for errors) and the market (i.e. customers, competitors). The indirect tax team should lead this part of the evaluation, ideally in collaboration with other affected functions, such as sales, procurement, and legal teams.

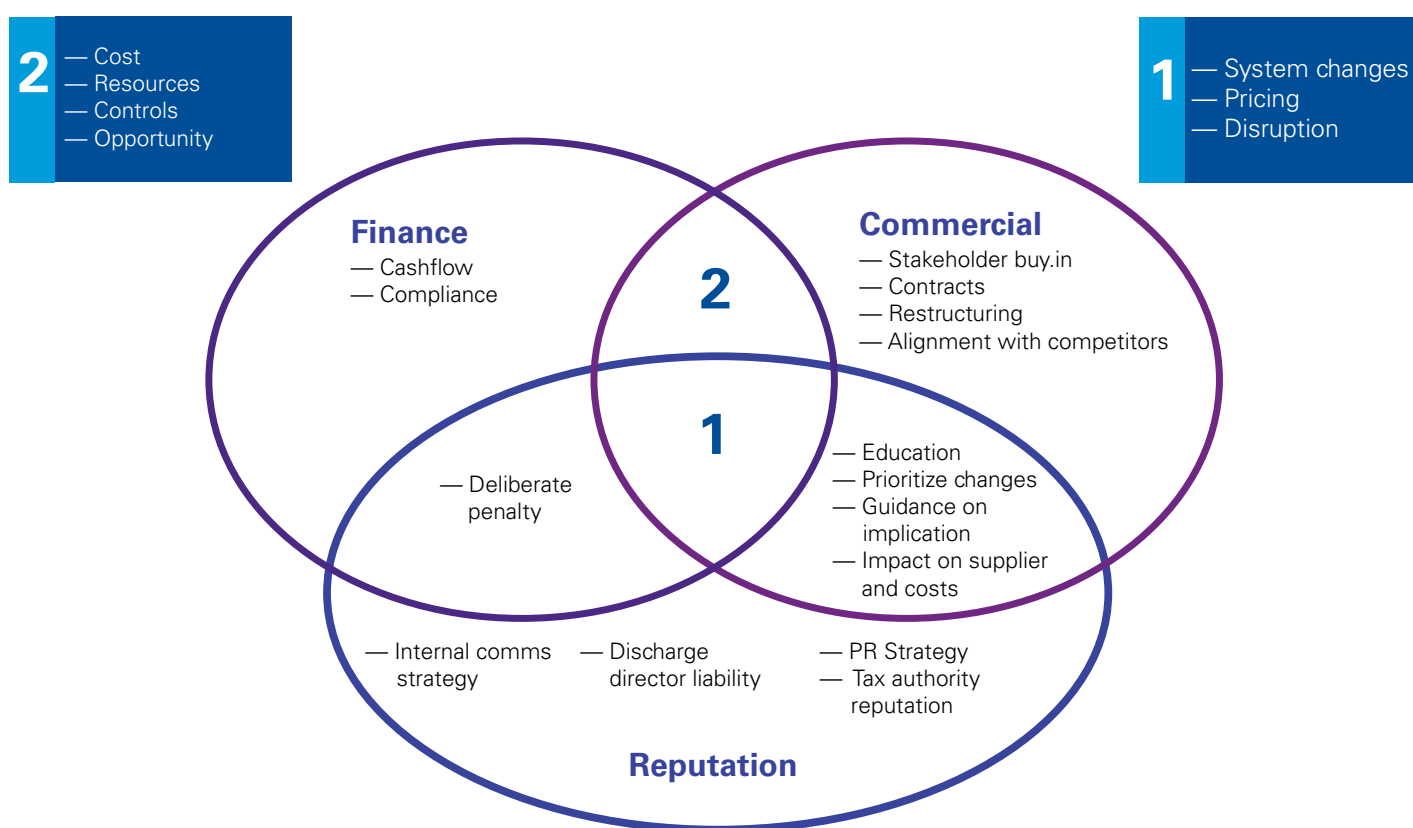
Regulatory change will have different and varying degrees of financial, commercial and reputational effects, and it is useful to begin evaluating potential issues through these lenses:

- **Financial impacts:** What is the impact of the change on cash flow, resources and compliance processes? These impacts are primarily quantitative.

- **Commercial impacts:** What does the change mean for products and services in the market? Could it make a product or service more or less competitive — or no longer viable? Are the terms of contracts with suppliers or customers affected? These are a mix of quantitative and qualitative impacts.
- **Reputational impacts:** How could the change affect the company's relationships with employees, suppliers, customers and the tax authorities? To what extent would

non-compliance create reputational costs? Could the change create liability issues for directors? These impacts are primarily qualitative.

Once qualitative and quantitative impacts in these three areas have been evaluated, the next step is to plan potential responses. For greater efficiency and effectiveness, responses for all three areas of impact should be reviewed together to determine where responses overlap.



Source: 2016 KPMG Global Indirect Tax Forum.

Responses to financial and commercial impacts of regulatory change can entail changes to cost structures, resource needs and sourcing models. Responses here can also involve taking advantage of any opportunities, for example, to develop or reengineer products, renegotiate contracts or restructure the supply chain.

Responses to commercial and reputational impacts often involve training staff, educating affected business functions and communicating with customers and suppliers. Where

responses to financial and reputational impacts intersect, a cost-benefit analysis may be needed to determine priorities. For example, the financial costs of complying with a change may be so high that the company may decide instead to accept penalties.

Responses common to all three areas include company-wide systems changes, price restructuring or actions to address business disruption.

### 3. Managing the impacts

Once you have determined the impacts of regulatory change on your organization and how you will respond, it's time to assemble a cross-functional team to put the responses in place. The response team's first task should be to develop a comprehensive project plan, setting out key deliverables, milestones and timelines.

The team should then decide how to communicate the plan to internal and external stakeholders, including affected staff members, customers and suppliers, and tax authorities. The plan should also call for regular updates for stakeholders as the project progresses.

The team would then take charge of executing the plan and, once completed, conduct a post-mortem evaluation, along with ongoing monitoring and follow-up.

### 4. Influencing regulatory change

In addition to mastering your organization's responses to regulatory change, you can also work to help shape these changes in ways that benefit your business and industry or at least mitigate any potentially adverse effects. In setting your processes for predicting regulatory change, you should already have a good understanding of the long-term triggers of regulatory change that are relevant to your business. Now, you can begin using this knowledge strategically to ensure your organization's business issues are taken into account and bring forward potential solutions for consideration.

For example, in response to the OECD's BEPS consultations on electronic commerce and cross-border transactions, the OECD received responses from over 60 potentially affected

businesses. These submissions went a long way toward ensuring the OECD's final recommendations in the area took practical business considerations into account.

You can build your indirect tax function's strength in influencing regulatory change by:

- tapping your network of spotters and catchers to keep up with opportunities to contribute your views to lobbying efforts, working groups and government consultations
- joining similarly affected organizations in lobbying groups and forums or, if no such group exists, by creating your own group or forum dedicated to influencing change
- developing collaborative working relationships with government and regulatory officials by taking time to understand their positions and by contributing your industry knowledge and experience
- determining whether you would be better positioned by entering a change dialogue early in the process or by watching and waiting (e.g. for formal consultations) to gain more information about the issues being considered and how things may unfold
- knowing how to pick your battles so you do not put undue time and energy into efforts that are unlikely to succeed
- supporting your positions and recommendations with strong, objective evidence, such as lessons from other jurisdictions or detailed economic analyses that model a change's potential impact.



Setting up and maintaining a framework for dealing with regulatory change can do a lot more than avoid having regulatory change catch you off-guard. It can also help your indirect tax function preserve and enhance value by giving you a complete view of a change before or as it occurs, how the change affects the financial, commercial and reputational aspects of the business, and what would be the most efficient and effective ways to respond. And by getting involved with the people, institutions and processes that drive and define regulatory change, you might be able to help shape new indirect tax rules and regimes in ways that contribute to your company's long-term success.

# Contacts

## Tim Gillis

**Head of Global Indirect Tax Services**  
**KPMG in the US**  
**Partner**  
**T:** +1 202 533 3700  
**E:** [tgillis@kpmg.com](mailto:tgillis@kpmg.com)

## Authors

### Chris Downing

**Partner, Head of Process & Technology**  
**for Indirect Tax**  
**KPMG in the UK**  
**T:** +44 20 7311 2684  
**E:** [chris.downing@kpmg.co.uk](mailto:chris.downing@kpmg.co.uk)

### Emmie Nygard

**Senior Manager**  
**KPMG in the UK**  
**T:** +44 20 7311 3643  
**E:** [emmie.nygard@kpmg.co.uk](mailto:emmie.nygard@kpmg.co.uk)

### Gary Harley

**Head of Indirect Tax Services,**  
**KPMG in the UK**  
**Partner**  
**T:** +44 77 8872 8683  
**E:** [gary.harley@kpmg.co.uk](mailto:gary.harley@kpmg.co.uk)

### Genevieve Watson

**Director, Indirect Tax**  
**KPMG in the UK**  
**T:** +44 20 7311 3889  
**E:** [genevieve.watson@kpmg.co.uk](mailto:genevieve.watson@kpmg.co.uk)

### Gisele Belotto

**Senior Manager, Trade & Customs**  
**KPMG in the US**  
**T:** +1 305 913 2779  
**E:** [gbelotto@kpmg.com](mailto:gbelotto@kpmg.com)

### John Bain

**Regional Leader, Americas Indirect Tax**  
**Partner**  
**KPMG in Canada**  
**T:** +1 416 777 3894  
**E:** [jbain1@kpmg.ca](mailto:jbain1@kpmg.ca)

### Niren Saldanha

**Partner, State & Local Taxes**  
**KPMG in the US**  
**T:** +1 212 954 3835  
**E:** [nsaldanha@kpmg.com](mailto:nsaldanha@kpmg.com)

[kpmg.com](http://kpmg.com)

[kpmg.com/socialmedia](http://kpmg.com/socialmedia)

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