A new era of transparency
Rethinking global compliance and reporting

The e-government revolution in Estonia
The role of tax in finance transformation
The importance of stakeholder relationships
Dear Reader

The Eurozone debt crisis provides a clear illustration of the challenges facing governments in many developed countries. With an increasingly unsustainable debt burden, many countries are taking measures to strengthen their balance sheet and restore public finances to health. The stimulus measures that were implemented to kick-start the global economy are being withdrawn and, in their place, a new environment of deficit-fighting austerity is taking hold.

At a time of considerable change and uncertainty in the policy environment, corporate tax executives must work harder than ever to identify, assess and mitigate emerging tax risks. They must get to grips with fast-changing rules across every jurisdiction and comply with myriad local regulations. As many companies look further afield for growth opportunities - often to emerging markets - they must ensure that their tax function keeps pace. A more diverse geographical footprint may increase growth potential, but it also introduces new tax risks that can prove extremely costly if poorly managed.

This increased complexity of the tax environment is coinciding with continued pressure on finance and tax functions to maximize efficiency and achieve greater economies of scale. Many companies have embarked on ambitious finance transformation projects to help them improve decision-making and reduce costs. These typically involve the migration of commoditized processes into shared service centers, a shrinking of in-country finance departments and the implementation of standard global processes.

This broader transformation of finance also gives companies a valuable opportunity to update their global compliance and reporting (GCR) processes. GCR comprises the key elements of a company’s finance and tax processes that prepare statutory financial and tax filings, as required in countries around the world. By standardizing these processes, and automating compliance and reporting, companies can free up time and resources to deal with value-adding activities. They can also achieve a clearer understanding of compliance and reporting and be better positioned to identify and manage emerging tax risks.

In this issue of T Magazine, we examine current best practice in GCR and explore ways in which companies are strengthening their compliance and reporting as part of broader finance transformation efforts. At a time when companies are facing an uncertain tax policy environment and a continuing need to maximize efficiency, GCR is a vital topic for discussion - not just in the tax function, but among the entire executive team.

We hope you find this publication valuable and stimulating.

Stephan Kuhn

Companies enter a new landscape for compliance and reporting

By Stephan Kuhn

Editorial

Your feedback

We work hard to make T Magazine useful and informative for our readers. But we would value your views on what we could do better. Feedback can be provided via the brief online survey, available here:

www.ey.com/tmagazine/survey

Stephan Kuhn is Area Tax Leader for the Europe, Middle East, India and Africa (EMEIA) region at Ernst & Young.
T Magazine about the key elements of his country’s competitiveness. Estonian President Toomas Hendrik Ilves talks to T Magazine about the key elements of his country’s efforts to bolster its competitiveness.

Estonia online

The East European country’s wide-ranging modernization efforts have helped it cut corruption and become an exemplar for others.

How e-government can shape competitiveness

Estonian President Toomas Hendrik Ilves talks to T Magazine about the key elements of his country’s efforts to bolster its competitiveness.

The importance of external relationships

Increasingly complex tax policy environments are driving firms to build stronger relationships with regulators.

Planning globally, taxed locally

Globalization is pushing companies to expand overseas, while also forcing them to consolidate finance functions. This in turn is creating new pressures.

Charting the burden of tax

A graphic representation of the varying levels of tax burden applied across various countries.

In-house or outsourced?

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A new, tighter world of rules and policies is emerging, which is pressuring tax and finance teams in a range of ways.

When finance transforms

The financial crisis is pushing companies to engage in wide-ranging exercises to transform their finance functions.

Management

Small global business, big global tax challenge

Large multinationals may be most often in the spotlight, but tax is often most taxing for small and midsize companies.

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**Tax reform in the spotlight**

The global economic turmoil of recent years has seen tax reform grow in importance around the world. Governments are under pressure to maximize tax revenue in the face of dire economic forecasts and giant deficits, and this has put the focus on tax avoidance, as well as tax evasion. Tax authorities are intensifying enforcement and compliance, making it easier to pay tax and trying to tackle long-exploited tax loopholes.

For companies, particularly multinational and large banks, the changing corporate tax landscape creates risk and uncertainty. Common practices involving transfer pricing, intra-group loans and offshore subsidiaries are now facing increasing scrutiny. There is also considerable public pressure on governments to stop corporate tax avoidance, as evidenced by the ‘Occupy’ movement, which spread around the world.

No area is more under the microscope than the financial sector. The OECD, IMF, G20 and EU all endorse various ways to get more tax from the financial sector. Global agreement on specifics is, predictably, a difficult problem, but there is general agreement the financial sector is undertaxed. Tax reform is more than cracking down on avoidance and evasion, of course. Governments know that tax revenue gets a boost with an improvement in administrative efficiency.

### 2011 Index of Economic Freedom

<table>
<thead>
<tr>
<th>Economy</th>
<th>Freedom Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Hong Kong</td>
<td>89.9</td>
</tr>
<tr>
<td>2 Singapore</td>
<td>87.2</td>
</tr>
<tr>
<td>3 Australia</td>
<td>82.5</td>
</tr>
<tr>
<td>4 New Zealand</td>
<td>82.3</td>
</tr>
<tr>
<td>5 Switzerland</td>
<td>81.9</td>
</tr>
<tr>
<td>6 Canada</td>
<td>80.8</td>
</tr>
<tr>
<td>7 Ireland</td>
<td>78.7</td>
</tr>
<tr>
<td>8 Denmark</td>
<td>78.6</td>
</tr>
<tr>
<td>9 United States</td>
<td>77.8</td>
</tr>
<tr>
<td>10 Bahrain</td>
<td>77.7</td>
</tr>
</tbody>
</table>

Source: The Heritage Foundation

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### International exchange of information for tax purposes

<table>
<thead>
<tr>
<th>Tax information exchange agreements and double tax conventions signed between G20 summits</th>
</tr>
</thead>
<tbody>
<tr>
<td>64</td>
</tr>
</tbody>
</table>

Source: OECD

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### Clamping down on tax

- **November 2008**: EU proposes tougher tax evasion rules. The G20 calls for international tax transparency to be “vigorously addressed.”
- **April 2009**: The G20 countries agree on a blacklist for tax havens, segmented according to a four-tier system.
- **May 2009**: US President Obama spells out proposals to close corporate tax loopholes available to US multinational corporations and crack down on overseas tax havens.
- **January 2010**: The OECD Informsal Task Force on Tax and Development is created.
- **March 2010**: President Obama signs the Foreign Accountant Tax Compliance Act aimed at preventing offshore tax abuses by US persons.

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### 2010

- **April 2010**: The IMF advises the G20 to enact a Financial Activities Tax.
- **June 2010**: The G20 reiterates commitment to addressing non-cooperative jurisdictions with respect to tax havens.
- **October 2010**: The European Commission backs the introduction of a financial activities tax in Europe.
- **May 2011**: The first of a series of special HMRC task forces is established to crack down on tax evasion and avoidance in the UK.
- **August 2011**: Switzerland agrees to tax money held in its banks by German citizens, with future income and capital gains subject to a final withholding tax.
- **September 2011**: Occupy Wall Street begins in protest against corporate greed, tax avoidance, corruption, lobbying and secrecy.

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**T Magazine news**

To keep pace with changing reader habits, we are delighted to announce an interactive iPad edition of T Magazine, to accompany the print publication, available free on the iuness store. We are also pleased to report that T Magazine was awarded Gold for Best Overall Editorial at the 2011 Pearl Awards, as well as the Nova Awards’ Silver prize for Online animation. The T Magazine website has also done well, winning Best use of Internet in the annual International Tax Review (ITR) awards. We strive to continue improving our content, but would welcome your views on where we can do better. Feedback can be given online at: www.ny.com/tmagazine/survey

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**Washington __ USA**

The IRS is fighting six US banks over tax credits they are claiming through “structured trust advantaged repackaged securities,” or STARS. The IRS claims that the deals – brokered between the American banks and a bank in the UK – were a “sham” designed only to exploit tax credits law. The banks are seeking reimbursement for disallowed tax credits totaling more than US$1b.

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**London __ UK**

The UK’s Revenue and Customs has launched a series of specialist task forces to undertake “intensive bursts of compliance activity” in specific high-risk sectors and locations across the United Kingdom. There will be 10 task forces set up in 2011–12 with more to follow in 2012–13 and the program aims to raise an additional £1bn each year by 2014–15.

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**Financial Transaction Tax**

German Finance Minister Wolfgang Schäuble has called on the EU to take steps toward implementing a financial transaction tax to curb speculative trading. The transaction tax has the support of EU Commission President José Manuel Barroso and European Union President Herman Van Rompuy.

### Source:

- IMF, US, the UK, China and India all oppose a financial transaction tax, despite agreeing (with Europe) that the financial sector is under-taxed. Instead, they support a financial activities tax, levied directly on compensation and profits, as the best way to raise money from the sector.

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**Credit:** Corbis / Demotix / Pat Phillips

**Credit:** Getty / Bloomberg

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Planning globally, taxe locally

Globalization and the drive for efficiency are causing companies to rethink their approach to compliance and reporting. Increasingly, the goal is a mix between global and local capabilities.

By Dr. Paul Kielstra

The clashing of two macro trends is creating a serious tax compliance risk for international businesses that do not plan wisely. The first of these is globalization, which has been fundamentally reshaping companies for many years: supply chains, production and logistics, for example, have for some time defied the constraints of borders in a world that Thomas Friedman famously described as flat. The second, which is less visible, is that companies have also increasingly consolidated and regionalized various back-office operations in a bid to cut costs and increase efficiency.

Finance functions in particular are undergoing this kind of overhaul right now. In Ernst & Young’s survey Seizing the opportunity in global compliance and reporting, conducted during 2011, 78% of respondents indicated that they were either in the middle of a significant financial function transformation, had completed one in the last two years or planned to engage in one in the next two years. Such a development is, in many ways, a natural outcome of current economic conditions. As Chris Kealy, EMEIA Leader, Global Compliance & Reporting for Ernst & Young puts it, “Companies are trying to remain competitive. They need to make a profit, and the top line is not growing, so they are maintaining profitability by decreasing cost.”

The need to reduce expenses is not the only challenge brought about by current financial conditions. “The level of scrutiny that corporate tax filings receive is going up as countries are strapped for cash,” explains Jim Hunter, Global Director of Business Tax Services for Ernst & Young. This is a global phenomenon that is not just limited to those countries worst hit by the financial crisis. Not only is enforcement getting more rigorous in developed countries facing low growth and high debt levels, but tax authorities in many emerging markets have also announced tougher standards and a more aggressive approach toward tax.

India, for example, has by far the highest number of transfer pricing-related cases before the courts of any country, at around 1,500. Penalties for such issues can be steep, ranging from about 40% of amended tax assessments in the US, to as much as 100% in countries such as Mexico or the United Kingdom. And firms may find that their viewpoints are overruled: in Russia, nearly two-thirds of corporations were assessed as having additional tax liabilities as a result of audits in 2010. Of these, less than a third of those penalized agreed with the changes.

Local pressures

Although enforcement is increasing worldwide, taxation remains a fundamentally local issue. Paul Weldon, Director of Accounting GPO at Microsoft, has helped the software firm create a global view of tax compliance across the more than 100 jurisdictions it operates within.

Paul Weldon, Microsoft
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Summary

Globalization is pushing firms to expand abroad, while competition is forcing them to consolidate to save on costs where possible. These twin forces create a specific challenge in how companies grapple with their global tax compliance and optimization needs.
High-performing companies drive efficiency, control and value across GCR

<table>
<thead>
<tr>
<th>Compliance and reporting elements</th>
<th>Value</th>
<th>Operating model</th>
<th>Business outcomes</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Control</td>
<td></td>
<td></td>
<td>- market reach</td>
</tr>
<tr>
<td>- Processes and systems</td>
<td></td>
<td></td>
<td>- operational agility</td>
</tr>
<tr>
<td>- Efficiency</td>
<td></td>
<td></td>
<td>- cost competitiveness</td>
</tr>
<tr>
<td>- Achieving the optimal balance</td>
<td></td>
<td></td>
<td>- stakeholder confidence</td>
</tr>
<tr>
<td>- Efficiency</td>
<td></td>
<td></td>
<td>- tax value</td>
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</tbody>
</table>

At the center of Ernst & Young’s framework to effectively manage risk and compliance are the key GCR operational elements. Given the agenda to improve performance, it becomes essential that business leaders assess where they are with GCR today in terms of efficiency, control and value.

Source: Ernst & Young, Seizing the opportunity in global compliance and reporting, 2011

Global firms are facing greater tax scrutiny

<table>
<thead>
<tr>
<th>Tax scrutiny issue</th>
<th>Proportion of firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unplanned tax audit</td>
<td>64%</td>
</tr>
<tr>
<td>Unexpected tax assessments</td>
<td>45%</td>
</tr>
<tr>
<td>Penalties</td>
<td>42%</td>
</tr>
<tr>
<td>Late filings</td>
<td>32%</td>
</tr>
<tr>
<td>Business interruption due to lack of compliance</td>
<td>31%</td>
</tr>
<tr>
<td>Deficiencies leading to reinstatement</td>
<td>11%</td>
</tr>
</tbody>
</table>

Source: Ernst & Young, Seizing the opportunity in global compliance and reporting, 2011

Outsourcing is helping with the skills gap

<table>
<thead>
<tr>
<th>Outsourcing issue</th>
<th>Proportion of firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Companies accessing outsourcing as an effective means of achieving business benefits</td>
<td>83%</td>
</tr>
<tr>
<td>Ability to employ people with appropriate level of local expertise</td>
<td>72%</td>
</tr>
<tr>
<td>Leveraging methodologies, expertise, etc. of service partner</td>
<td>62%</td>
</tr>
<tr>
<td>Ensuring flexibility and scalability of sourcing solution</td>
<td>61%</td>
</tr>
<tr>
<td>Reducing costs and increasing predictability of costs</td>
<td>46%</td>
</tr>
<tr>
<td>Reducing headcount and full-time equivalents</td>
<td>43%</td>
</tr>
<tr>
<td>Improving all aspects of operational and execution risk</td>
<td>43%</td>
</tr>
</tbody>
</table>

Source: Ernst & Young, Seizing the opportunity in global compliance and reporting, 2011

Regulation is adding to the need for GCR

<table>
<thead>
<tr>
<th>Regulation issue</th>
<th>Proportion of firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Significance of regulatory change and tax audit activity to GCR activities in the next 12-24 months</td>
<td>96%</td>
</tr>
<tr>
<td>New and changing legislation and tax regulatory requirements</td>
<td>85%</td>
</tr>
<tr>
<td>Increasing tax audits and controversies</td>
<td>83%</td>
</tr>
</tbody>
</table>

Source: Ernst & Young, Seizing the opportunity in global compliance and reporting, 2011

GCR processes lack standardization

<table>
<thead>
<tr>
<th>GCR processes issue</th>
<th>Proportion of firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Companies with global standards for GCR processes and systems</td>
<td>64%</td>
</tr>
<tr>
<td>Tax provision preparation</td>
<td>48%</td>
</tr>
<tr>
<td>Statutory accounting and reporting</td>
<td>30%</td>
</tr>
<tr>
<td>Income tax compliance</td>
<td>14%</td>
</tr>
<tr>
<td>Indirect tax compliance</td>
<td>14%</td>
</tr>
</tbody>
</table>

Source: Ernst & Young, Seizing the opportunity in global compliance and reporting, 2011

Lack of skills is a barrier to GCR

<table>
<thead>
<tr>
<th>Lack of skills issue</th>
<th>Proportion of firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Significant lack of skills resources as a barrier to move to a global or regional GCR operating model</td>
<td>18%</td>
</tr>
<tr>
<td>Very significant</td>
<td>39%</td>
</tr>
<tr>
<td>Somewhat significant</td>
<td>39%</td>
</tr>
<tr>
<td>Not significant</td>
<td>9%</td>
</tr>
</tbody>
</table>

Source: Ernst & Young, Seizing the opportunity in global compliance and reporting, 2011

Overall, this “shadow tax function” can get the basic job done. However, companies that handle tax in this way have increasingly become aware of the weaknesses of this approach. One primary concern is that this does not provide an effective global view of tax issues for corporate head office, or allow for effective governance. Not only does this impede global tax planning, but executives at the group level usually only get to hear about problems - such as failures to file - when they are already crises.

The ongoing consolidation of finance into regions, global shared service centers makes matters worse. The elimination of many local positions entails the loss of local tax expertise. As Weldon puts it, finding someone at Microsoft’s EMEA shared service center in Poland, who has the necessary expertise in the intricacies of VAT or other tax issues in South Africa, Nigeria and Spain, to name just a few countries, is a significant challenge. As such, shadow tax functions, with their limited capabilities, require replacement.

The biggest mistakes

Surprisingly, not all businesses see this problem coming. “When a lot of companies undergo a shift globally in the finance function, local tax and accounting needs are a bit of an afterthought,” says Hunter. Others agree: “The biggest mistake we see is that companies don’t put enough effort into addressing the tax function,” says Kealy. “They think that tax compliance is something where you can just press a button.” This is especially the case for indirect taxes: Ernst & Young research indicates that, of those companies engaging in financial transformations recently, just less than half (48%) included indirect compliance processes in the planning and one-quarter of these did so only after the change had begun. The figures for direct taxes are not much better: just 56% included planning for tax provision preparation as part of their finance transformation.

The biggest mistake we see is that companies don’t put enough effort into addressing the tax function. “You don’t have as many surprises,” says Kealy. “Once you have governance around your compliance and reporting obligations, you should be able to reduce the number of surprises around unplanned tax audits, penalties and interest.”

Microsoft’s Weldon agrees: “Having the corporate oversight is a very big advantage. I definitely feel that we have lowered our risk profile.” (See case study: Microsoft’s switch to global compliance and reporting.)

Squaring the circle

How, then, can companies avoid the compliance and reporting dangers associated with the function transformations that are so important in the current competitive environment? The most effective way is to shift toward a global compliance and reporting (GCR) governance platform, which balances a cross-company, worldwide overview of the company’s compliance and reporting, with the use of local expertise in completing the appropriate filings.

Other articles in this issue of T Magazine deal with many of the practical matters involved in setting up effective GCR models, including the particulars of organization, technology, resource allocation, outsourcing and risk management. The initial requirements for any company, as with most things, is to name just a few countries, it is a significant challenge. As such, shadow tax functions, with their limited capabilities, require replacement.
Such insight can also provide substantial value to a company when making decisions ranging from operations to mergers and acquisitions. The ability to provide such advice is part of the evolution that Kealy sees in tax departments as a whole. Heads of tax, he explains, used to have to be more technicians in the area of preparation and filing; now they need to take on more managerial and strategic roles. Someone in such a position now should be not only tax technically qualified, but also understand the financial and operational sides of the business.

Such an evolution is often welcomed. Financial controllers are usually judged on their main role as business partners who help run the business, explains Weldon. “Tax-related activity is a requirement, but not the core of what they are paid to do,” he says. “Taking care of it for them [through a company-wide GCR function], so they can focus on business insight is a well-received cultural change.”

The other element of an effective GCR model is to arrange how to tap into the necessary local expertise. This often involves some level of outsourcing. As Kealy points out: “There are a lot of peaks and valleys in tax filings. If you are staffing up to handle those peaks, you may have people who are idle at other times.” In addition to cost-effectiveness, expert local knowledge can bring other advantages. For example, when providing GCR services, companies often find other local requirements that need to be addressed, such as administrative and corporate secretarial filings. Those who are outsourcing GCR processes find the ability to access a heightened level of expertise to be the main benefit.

**Plan now or pay later**

In a global, integrated economy companies can no longer afford to treat tax and their compliance and reporting needs as an afterthought, with local filings done by employees when they can find time away from their main duties, sometimes without any relevant training. Moreover, the consolidation and centralization of finance functions is eliminating both slack time in the system and the number of people with local expertise necessary to support shadow tax functions. More aggressive enforcement by governments, meanwhile, is making it all the more important to have a global-level focus on tax issues.

The solution to these problems is a company-appropriate GCR model. Such an approach brings other benefits as well, notably an ability to do more effective tax planning and to access the necessary local expertise in the most cost-effective way. For most companies, moving to a centralized finance function and elimination of local country expertise is a pretty big operational shift, but given the rising number of audits and penalties, the alternatives are not palatable and an effective GCR business model is a must.

**Tax agreements**

At the Global Forum on Transparency and Exchange of Information for Tax Purposes, OECD Secretary-General Angel Gurría highlighted how governments are increasingly collaborating to help raise revenues, including the signing of more than 700 international agreements between governments to exchange tax information. The initial scheme was to have one outsourced provider handle both accounting operations and tax work, with a third-party advisor reviewing and signing off on the tax filings before their submission. In practice, however, this approach fell short. The hope had been that the tax preparers would slowly build up expertise in the relevant regulations of all the countries for which the shared service center did filing, eventually making the third-party advisor unnecessary. It quickly became apparent that such learning by doing was an expensive, inefficient way to train preparers, especially as their expertise was typically on financial issues, rather than tax specifically.

**Responsible for filings**

The revised approach was to make better use of the in-depth local knowledge that a third-party advisor would have. In this approach, rather than reviewing and correcting the tax filings, the advisor becomes responsible for preparing them, based on data provided by the shared service center. This model allows certain benefits. “We have local expertise, but are as centralized as we can be with as low a cost as possible where it doesn’t require such knowledge,” explains Weldon.

With the system in place, the company has also been able to create a greatly enhanced system of governance around it. “We now know in a real-time way where we are with, for example, local VAT returns for the current month,” says Weldon. “We have a dashboard to show where we are and we can see if something is late.” This allows the company to identify and solve problems before they escalate into something more serious. But more work remains. The next stage involves engaging with the larger international tax group inside Microsoft to use the information and expertise available as a part of its larger tax strategy. “That is a step we are talking about,” says Weldon.

**OECD Secretary-General Angel Gurría at the 2011 Global Forum Meeting in Paris.**
A changing burden

Governments face a difficult balancing act in the wake of the financial crisis. To cope with soaring public debts, it is crucial to raise revenues. But lowering taxes can often help to kick-start a recovery. As such, various countries are following different paths in terms of the relative burden of tax that they place on companies, as well as the time and effort involved in actually filing and paying tax.
Toomas Hendrik Ilves
President of Estonia

Now President, Toomas Hendrik Ilves has served Estonia in a range of roles, from Foreign Minister and a Member of the European Parliament, to local Member of Parliament and Ambassador to the United States.

1999
The year that Estonia’s government went paperless, en route to providing a range of e-government services to citizens.

How e-government can shape competitiveness

Estonian President Toomas Hendrik Ilves talks to T Magazine about two key elements of his country’s competitiveness: the use of IT to create effective e-government infrastructure and the institution of a flat income tax. Interview by Dr Paul Kielstra

T Magazine: In your experience, how does e-government affect the way that government functions?
President Ilves: The most fundamental benefit is transparency. We have been living with that for 15 years, but you forget how rare it is. I was at an UN General Assembly meeting, listening to various heads of state saying that they had put expenditure [data] online. But that is only the very beginning of e-government.

How does it affect the work of government officials? It has basically freed up a lot of civil servants. You don’t have people doing rote things that can be done by machines, which is important because our fundamental problem is our size.

In my work, I’m not a passive recipient of e-government. Outside of Northern Europe and the United States, people don’t necessarily understand at the level of head of state that e-government is about the way people operate, not the technology. People who do understand this are those currently in their 30s.

I’ve been using an Apple Computer since 1983. The government was paperless by 1999.

It’s not a big deal. I have a Facebook page, but that is trite. Anyone can do that. E-government has nothing to do with people in government having computers. It means you do things completely differently. For example, our health records are all on line. You are defrocking the priesthood of the medical profession. The patient owns his own data in the marketplace.

Where there are complicated tax schemes, people don’t pay taxes

It’s not just government, though, it’s more a matter of the attitude of society. For example, I’m shocked when I have to pay to use Wi-Fi. In Estonia, it’s just there. My daughter sees what her homework is on e-school. It is all very normal when you are living there.

For it to work, you must have a completely reliable ID system so that you can sign legal documents. The other thing you need is a decentralized data system, not just one big computer. You have access to everything as the
citizen; police can access your police records; doctors can access your health records; but the tax authorities, say, cannot access your health records. You are the owner of the data. Another reason it works is that, basically people think it's cool.

After nearly two decades of experience with the flat tax, what do you see as the benefits and drawbacks of such a system in practice? The flat tax has been adopted by many countries. Some places it has worked, some it hasn't. The real benefit is in compliance, which comes from having a very simple computer-based tax return. This is where we differ from all kinds of countries. Where there are complicated tax schemes, people don't pay taxes. There are not any major down sides. If you compare the corruption levels, debt, and deficit spending.

Estonia adopted the Euro at the start of this year. Was this a case of bad timing or do the long-term benefits still outweigh the risks? Well see what happens with the Euro zone, but for the short-term the benefit for us has been that it meant the re-establishment of investor confidence in Estonia. It is kind of like a Good Housekeeping Seal of Approval. It has eliminated the threat of devaluation, which was the biggest threat of all, a forced devaluation which would have wiped out people's (savings).

What lessons does your country's recent experience of adopting austerity measures hold for other states? Do what you think is doable. One of the things we did have, which others might not, was the equivalent of 10% of GDP in our reserves. This is a big buffer and we didn't have to go to the IMF, I don't know how to tell people to save, other than to say "save". Also, the experience of life under the Soviet Union makes it easier. It is still in historical memory. Anyone over 25 in Estonia remembers the Soviet Union and how awful it was. Compared to that, (austerity) isn't so bad.

Estonia recently dropped to 24th position from the 18th in the World Bank's Doing Business Report. Was this fair? There is an image that has existed for 70 years about Eastern Europe, that its countries are poor, backward and corrupt. It's time to get over it. Look at Estonia and look at some other European countries (and compare) the corruption levels, debt, and deficit spending.

Estonia, located at the heart of the Baltic Sea region, has a modern market-based economy and one of the highest per capita income levels in Central Europe. With a population of 1.3 million, Estonia is the smallest of the Baltic states. The country joined the European Union in 2004. Today, it enjoys high levels of investment, financial freedom and property rights while the top income and corporate tax rates are relatively low, compared with other countries. Estonia managed to adhere to Maastricht's strict deficit rules and joined the Eurozone on 1 January 2011. According to the Ernst & Young Eurozone Spring 2011 Forecast, Estonia will be the fastest-growing economy in the Eurozone over the next four years.

Estonia and the Baltic region

Estonia online

The country's wide-ranging efforts to put government online have helped cut corruption and create a highly efficient business environment. In doing so, it has become a model for others.

By Kim Thomas

I may have a population of only 1.3 million, but Estonia also has one of the most advanced systems of electronic government in the world. Using the internet, locals can vote, view their medical history, set up a company and file their tax return. The expectation that a transaction should be available over the internet has become so prevalent that even bus tickets and car parking spots are now bought via mobile phone, and queuing at the bank is largely unnecessary: 98% of banking transactions are carried out electronically.

The popularity of the online tax system is testament to the success of Estonia's efforts to implement e-government over the past decade. All corporate tax returns have to be filed online by law, but 93% of personal tax returns are also filed online, compared to 78% in the United Kingdom. This high take-up was driven by a simple incentive. Citizens typically overpay tax during the year, and then receive a refund at the end of the next year. When people file a paper return, the refund can take up to 120 days to arrive. By contrast, those people filing their taxes online receive their refund within five days.

The mass adoption of online taxation has resulted in significant efficiency improvements for both citizens, business and government, says Priit Alamäe, CEO of Webmedia, an Estonian technology company that has been heavily involved in the e-government project. "When you did it on paper, it would take a whole day. You
Estonia's economy

Unemployment 16.9%
Labor force 686,000
Public debt 7.7% of GDP
GDP per capita €15,821
Importa 9.26%
GDP growth 3.1%
Trade surplus 2.4%

Estonia’s government has implemented wide-ranging online services, from voting and education, to tax returns and refunds. Source: Ernst & Young Estonia

Estonia's economy

Experts €8.7bn
Inflation 2.9%

Key indicators of 2010

21% The cost-based Estonian tax system with its flat rate of 21% is considered one of the most innovative tax regimes in the world. Deferred taxation means that firms only pay tax when they distribute profits, not when they earn them.

An ongoing drive is underway to enable access for the 32% of households not currently online, which are mostly in remote rural villages. This is an urgent priority, as the government aims to ensure that all Estonian households, enterprises and institutions have access to broadband with a speed of up to 100Mb/s by 2015. The Estonian Broadband Development Foundation is currently building a network of fibre optic cables across the country to make that possible. In the meantime, Wi-Fi is very widely available free of charge in libraries, cafes, hotels, petrol stations and airports. “In Estonia, we consider the internet a human right,” says Alamäe. “We get very annoyed if we go to a cafe and there is no free Wi-Fi.”

Businesses typically take 85 hours to pay tax, compared with an average of 186 hours in the OECD

Estonia has a flat corporation tax rate of 21%, one of the lowest in the world. This is calculated based on financial accounting, but when dividends are paid to shareholders, or investments or merely retained. Tax is only applied if undistributed profits are not taxed, regardless of whether they are invested or merely retained. Tax is only applied when dividends are paid to shareholders or when hidden profit distribution is made, for example for donations.

Successive Estonian governments have pursued a free market, pro-business economic agenda and have wavered little in their commitment to pro-market reforms. The priority has been to sustain high GDP growth rates – an average of 8% per year from 2003–07. The Estonian economy benefits from strong electronics and telecommunications sectors as well as strong trade ties with Finland, Sweden and Germany. The current government has pursued sound fiscal policies, resulting in balanced budgets and low public debt.

Business climate: The overall freedom to conduct business in Estonia is well protected under a transparent regulatory environment. For example, starting a business takes an average 7 days, compared with the world average of 35 days. Foreign and domestic investments are treated equally under the law, and this makes Estonia a leading country in Central and Eastern Europe in terms of attracting foreign direct investment (FDI).

Estonia’s economy

Estonia, the capital, before being sold to eBay several years ago for US$2.6b in 2005 (and was recently resold to Microsoft for US$8.5b). All this has come as a result of the country’s wide-ranging efforts to professionalize and modernize its business environment. The World Bank now ranks it 24th out of 183 countries in terms of the ease of doing business, ahead of countries such as Switzerland, Belgium and France. From a tax perspective, e-government has helped local firms reduce their administrative burden, especially relative to other countries. It takes an average of 85 hours per year for a business to pay tax, compared with an average of 186 hours across the OECD, for example. Nevertheless, there is still scope for improvement here: Estonia’s 2011 World Bank ranking fell nine places to 51st globally, in part relating to changes in the tax code, to help cope with the effects of the financial crisis, rather than a drop in efficiency overall. E-taxation also makes life easier for the citizens of Tallinn, the capital, where officials estimated that returning between 2005 and 2010 to send transactions between the government and citizens, for instance, has reduced the time it would have taken them to fill out forms for donations.

Estonia’s digital nation

Estonia as a prime model

Successful Estonian governments have pursued a free market, pro-business economic agenda and have wavered little in their commitment to pro-market reforms. The priority has been to sustain high GDP growth rates – an average of 8% per year from 2003-07. The Estonian economy benefits from strong electronics and telecommunications sectors as well as strong trade ties with Finland, Sweden and Germany. The current government has pursued sound fiscal policies, resulting in balanced budgets and low public debt.

Estonia’s experience in building a nation online is one of the most innovative examples of e-government in the world today. Estonia is widely regarded as the least corrupt country in Central and Eastern Europe. Estonia as a prime model

Estonia’s government has implemented wide-ranging online services, from voting and education, to tax returns and refunds.

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Estonia’s government has implemented wide-ranging online services, from voting and education, to tax returns and refunds.
New constraints

The financial crisis is pressuring tax and finance teams in a range of ways, with firms facing a minefield of issues to navigate their way through.

By Dan Armstrong

The squeeze of regulation is becoming harder to escape. This is not solely because the rules have become stricter. In fact, many European regulations proposed after the 2008 market collapse have been put on hold as policy-makers grapple with the Eurozone crisis. Yet the trend is clear: a new, tighter world of rules and policies is taking shape, which are putting new pressures on corporate finance and tax teams.

As a result, companies are being forced to add resources, invest in oversight and spend more time dealing with regulatory bodies. Not all of the following long-term trends apply to every country or industry, but collectively they highlight the new challenges and complexity that businesses face.

Governments need more revenue: the aftermath of historic banking crises is usually associated with an explosion of government debt. This crisis is no different, with individual and corporate taxpayers ultimately picking up the tab.

There is more public awareness: tax avoidance has become a very high-profile public issue today. From demonstrations against rock band U2 to the global spread of the Occupy Wall Street demonstrations, public anger against the idea of tax avoidance has grown.

Firms are being made to disclose more information: global companies face rising pressure to increase disclosure, including every aspect of their financial activities, to a myriad of regulators around the world.

Governments are embracing technology: data mining tools are increasingly being used to detect questionable tax claims, such as the United Kingdom’s Fraud and Error Assessment Tool (FEAST), announced in June 2011, which analyzes and identifies potentially suspicious tax credit applications.

There is more cross-border cooperation: by late 2011, the OECD’s Global Forum on Transparency and Exchange of Information for Tax Purposes will have issued peer reviews on 60 countries, including many offshore financial centers. These increase the exchange of tax information across borders, cutting down on secrecy.

New incentives for whistleblowers: under proposed US rules, anyone can get paid for revealing compliance breaches, even third parties who have signed non-disclosure agreements.

More distractions: in 2009, European regulators publicized the broad objectives of new rules for financial service providers. But the sovereign debt crisis has delayed the process, with little chance of a full overhaul until 2013, at the earliest. As a result, financial services firms face significant regulatory uncertainty.

Rules with broader scope: the coming raft of new European derivatives regulations will affect end users who use derivatives to hedge, not just the intermediaries that structure and sell the products. Any entity with trading operations over a certain threshold will be subject to rules on trade repositories and clearing houses. Avoidance, not just evasion, is being targeted: the United Kingdom has begun to look into a “General Anti-Avoidance Principle” designed to fight transactions with tax avoidance as the main objective. It is one more sign of the willingness of governments to abandon past practices in order to capture more revenue.

For corporate tax and finance teams, finding a safe path through all these wide-ranging challenges is becoming more difficult. Resources are part of the answer. A bigger part is the ability to consider tradeoffs, weigh risks and make choices — while simultaneously preparing to respond to the unexpected. 

Greater pressure on tax compliance

Multinational companies are coming under increasing pressure to disclose the activities of their subsidiaries in every country where they operate, as part of wider pressure by governments to raise revenue. This has growing public support with protestors in particular arguing for greater taxes on banks. Combined with wider protests against government cutbacks, all this has served to raise the issue of tax avoidance in the public consciousness, making it a far more high-profile issue.
Countries are expanding tax collection teams

Last December, the Greek Finance Ministry established the Financial and Economic Crime Unit, which reports directly to the finance minister and is equipped with extensive powers. But as it is very labor-intensive to collect taxes from the 97% of Greek businesses that have nine or fewer employees, and meeting the demands of the EU, IMF and European Central Bank may require more focus on the larger 3%, Greece is not alone in this: other countries are expanding their tax teams too.

A tidal wave of regulation aimed at taming financial crises is adding new challenges. Can your customers and suppliers keep a secret? New US Securities and Exchange Commission rules proposed under the 2010 Dodd-Frank bill give them an incentive not to. Whistleblowers can get paid for revealing “original” information about a company, even if it is simply based on an analysis of public information. That gives companies a strong incentive to vet all disclosures to outsiders, even if they’re covered by non-disclosure agreements.

The number of pages of the Dodd-Frank Act, compared to the 66 pages of the 2002 Sarbanes-Oxley Act

849

Credit: Reuters / Thierry Roge

€15b

Estimated cost of widespread tax evasion to Greece each year

Credit: Keystone / AP / Charles Dharapak
Focus / Under pressure

Credit: Keystone / AP / Joel Ryan

Crackdowns on tax avoidance

In 2011, the British Chancellor of the Exchequer, George Osborne, announced laws to shut down “an aggressive tax avoidance scheme” of “contrived circular transactions” by unnamed businesses. The Government said that “hundreds of millions of pounds of tax revenue” could be lost. The term “avoidance” is rapidly losing its relatively benign connotations, as public officials start to publicly associate tax avoidance with tax evasion.

Credit: Keystone / EPA / Stefan Rousseau

Public pressure to crack down on tax avoidance is rising

At the 2011 Glastonbury music festival, United Kingdom, activists launched a balloon with the words “U Pay Tax 2?” when the band U2 went on stage. Years ago, U2 joined some of the Rolling Stones in transferring a proportion of its assets to the Netherlands, which, given its competitive tax regime and broad tax treaty network, can be attractive to many who, like U2, earn considerable income from passive sources.

£900m

Amount that the UK’s HMRC will spend in the four years from April 2011 to tackle non-compliance

$195m

U2’s estimated earnings between May 2010 and May 2011, according to Forbes
When finance transforms

Advances in enabling technologies and outsourcing capabilities are spawning a new breed of finance department. Tax departments should embrace the associated opportunities.

Summary
The financial crisis is pushing firms to engage in wide-ranging exercises to transform their finance functions, in order to achieve new efficiencies. But in doing so, tax is too often an afterthought. This is a mistake, as tax can benefit from such a change.

By Bill Millar
The well-run finance function has always been adaptable to change. But today’s conditions are spurring many groups to initiate wholesale transformation of their internal financial operations—including tax. The drivers for financial transformation are many and varied. Advances in telecommunications and networking technologies are enabling a burgeoning marketplace in financial process outsourcing. Third-party providers are harnessing these technologies to achieve remarkable advances in terms of breadth of services as well as improvements in cost, quality, scalability and flexibility.

Companies are also seeking greater efficiencies in operations against a backdrop of an economy that, for the most part, remains chronically anemic. The net result is a surge in the number of organizations initiating a top-to-bottom restructuring of their financial operations.

A better way
For Ann-Sofie Danielson, Chief Financial Officer of Sweden’s NCC, the finance function exists in a state of constant evolution. But in the wake of the recent financial crisis, the impetus to strengthen the finance function has become even greater. As one of the world’s leading construction and property development companies, NCC has felt a direct impact from the crisis. “We were focusing on improving the finance function before the troubles began but, as the recession became more evident, our drive became clearer,” says Danielson.

Such transformations look at the whole of the financial processes and then ask the question: is there a better way? The most effective finance transformations begin with a clear assessment of the mission. “Before you can design an ideal finance function, you have to be certain of what it is you want your finance function to accomplish,” says Paul Wood, EMEIA Leader for the Finance Function at Ernst & Young. The tasks conducted by a finance function vary from basic processes, such as managing routine accounting and cash management, to more complex issues, such as taking responsibility for compliance and financial risk management.

The idea is to identify common processes across the business, then centralize and simplify them.
Sweden’s NCC has implemented a shared service center to centralize and standardize its finance processes.

When consolidating and relocating finance functions...

Watch out for the transfer pricing trap and the VAT attack

The transfer pricing trap. People do not always associate their finance function with their supply chain. But tax is directly linked to payments and receipts all along the value chain - and that means there’s a profit component. Host nations generally assume a profit margin on business support functions as a percentage over costs. “So when you relocate your finance operations, you have to realize that you’re also moving a portion of your profits,” says Oliver Davidson of Ernst & Young’s EMIEA Financial Services Office.

The significance of this will vary depending on the amount of turnover and the jurisdictions in question. For example, a profit allocation of 10% or 20% over costs is fairly common among most jurisdictions that are attractive to shared service centers. “Companies need to factor these transfer pricing implications and risks into their planning and decision-making,” says Davidson. The VAT attack. Another challenge is managing the potential impact of VAT on supplies that were previously internal financial processes. “If a company engages an outsourcing provider for financial services, it must, in certain cases, pay VAT on the associated fees to the third party,” says Davidson. “This not only creates a compliance burden, but could also result in creating tax costs that erode efficiency savings and cannot be offset with losses or other taxes paid. If a company doesn’t actively plan for such contingencies, it could run into some nasty surprises.”

A finance transformation can in fact be extremely beneficial for the tax department

A shared services center,” says Wood. “But before you bring that number down to 25 or 20, you need to know exactly who is doing what and when.”

For this reason, Wood recommends that businesses invest the time to understand current processes before designing new ones. “You need to spend a great deal of time documenting the current workflows,” he explains. “You must reconcile that work against your intended design and ensure that there is nothing critical at the local level that won’t get done as a result.”

Goals that open up as a result of new processes can be significant and damaging. Consider, for example, a company that fails to complete a customs document, leading to a seized shipment or a missed VAT payment. Or alternatively, a company might risk creating a conflict of interest – perhaps enabling a single employee to be both an approver and an executor of an ongoing set of financial transactions. “You need to put in the time to really understand how the business gets done before you reassign your resources,” advises Wood.

Beyond an understanding of the form and flow of finance function processes, companies should also gather insight into the associated costs. “Most companies do not have a good handle on their baseline costs,” says Mahesh Makhija, Vice-President at the global IT and consulting services firm Infosys. “For example, they do not understand the cost of processing an invoice or of any of the various tasks they perform.”

This places companies at a disadvantage as they pursue any reconfiguration of the finance function. “Without this fundamental understanding, you have no way of gauging the benefits of redesign, or of working with an outsourcer.”

The opportunities in tax

Although an important strand within the finance function, tax departments are often given limited engagement when it comes to finance transformation. According to Lee, there have, in the past, been cases where the tax department might not have learned about finance function reorganization until it was well under way or even after the fact. Companies today tend to pay closer attention to such issues. “There is a growing realization of how embedded tax is within other finance and treasury processes,” says Lee.”But tax teams also need to be a lot more proactive. When they hear about such changes, they can’t just attend the meetings, they need to become active participants.”

A finance transformation can, in fact, be extremely beneficial for the tax department. In many cases, current finance and treasury processes have been designed to treat tax as an afterthought. Rather than incorporate the information needed for tax-related tasks into data capture and processing flows, the result is that the tax function must spend a lot of time manually manipulating data to meet its reporting requirements. “The work is often dull and repetitive, and definitely of the sort of value-added stuff a strong tax manager should be performing,” says Lee.

For tax departments, this is therefore an opportunity not to be missed. “I think that few companies would be willing to invest in an overhaul of their processes simply to improve a few inefficiencies within the global tax department. But by participating in a broader finance transformation program, tax directors have an opportunity to get involved on the ground floor in process redesign and optimization.”

![Image](Image 30x26)
Small global business, big global tax challenge

As SMEs expand into new markets in search of growth, they are also finding new tax difficulties.

By Rodrigo Amaral

L

arge firms aren’t the only ones with international aspirations. In developed economies in particular, small and midsize companies (SMEs) are also striving to compete globally in their quest for growth. According to the Federation of Small Businesses (FSB), for example, almost one-quarter of Britain’s SMEs trade with foreign markets. But in doing so, many are finding that while new markets offer many opportunities, they also expose these companies to a new set of compliance risks of which they are not familiar in dealing with. This is already the case within typical developed export markets, which already place greater demands on tax functions. But it’s particularly true within emerging markets, which have held a magnetic allure for firms of all sizes. Many of these countries have some of the world’s most complex tax systems. Compared with their bigger rivals, this is especially challenging for SMEs: they need to comply with all relevant rules, but with far fewer resources at their disposal.

Being fully compliant across operations in different countries is a challenging task for most companies, no matter their size. In Brazil, for example, companies famously spend an average of 2,600 hours a year to prepare, file and report their tax commitments. This provides an extreme example of tax complexity, but it is by no means the only one. Companies in economies such as China and India suffer from similar problems, while tax compliance is also demanding in countries such as Germany, France and the United States. Worldwide on average, a standard small or medium-sized business spends three working days a month complying with tax obligations, according to the World Bank in its latest Doing Business report. It notes that high compliance burdens mitigate investments and create incentives for entrepreneurs to work in the black economy. This is particularly true in developing economies, where large informal sectors contribute to the creation of an uneven playing field for SMEs.

The need for expertise

SMEs often realize that procedures and documentation processes that are proven winners at home may not be relevant in other jurisdictions. “If a company is not aware of the rules, it can trip over and quite innocently face some risks and problems,” notes Mackenzie. The FSB advises smaller firms to bring in expert advice in the form of accountants with knowledge of foreign trade. The extra costs involved pale in comparison with the potential costs of a tax inspection in a firm’s foreign operations. Depending on the size of the local operations, it may also be worth hiring a local with the relevant expertise, says the FSB.

Whether internal or outsourced, there is a clear argument for having on board professionals with thorough knowledge of any new markets being targeted. At the very least, successfully dealing with officials depends to a great extent on speaking the same language and adapting to their ways of relating to taxpayers. “Cultural understanding is very important if you are dealing with local regulators and tax authorities,” says Fiona Barnett, a leader at Ernst & Young in London. “Usually, the accepted strategy involves dealing with the issue early in the process of setting up shop in a new market,” says Mackenzie. If not, the company risks discovering that any assumptions made in setting costs and prices have been understated. The taxes that SMEs might pay in different markets varies to a significant extent, ranging from profit-based and turnover taxes to payroll taxes, as well as indirect taxes like VAT. Meeting compliance and reporting obligations for all of these can represent a significant burden. “Given how global and connected we are, and the way businesses are often set up, they can find that they have just created tax liabilities without even realizing that they are doing it,” Mackenzie says. “It could mean that the company is actually losing rather than making money with their foreign operation.”

Competitive impact

According to the Organisation for Economic Co-operation and Development (OECD), the need to comply with complex tax rules can constitute a significant competitive disadvantage for SMEs in certain markets. Although they spend much less money on compliance than their larger rivals, their costs as a ratio of total revenue can be much higher. The International Finance Corporation (IFC) notes for instance that micro-companies in the Ukraine need to comply with profit tax, VAT and payroll taxes, with costs reaching up to 8% of their revenues. Such firms are also increasingly targeted by tax authorities. Among Ukrainian companies with an annual turnover between US$625,000 and US$4.37m, 70% reported being targeted by tax audits in 2007. Given this, tax compliance can make a huge dent in an SME’s overall competitiveness.

It’s not all bad news though. Some countries have already adopted simplifying measures that are aimed at easing tax compliance burdens for SMEs. In South Africa, a simplified code for such firms has been devised to reduce their tax compliance costs from 5% to 2% of turnover. Tunisia has reduced the time that companies spend doing tax compliance by 84 hours every year, with the introduction of improvements, such as an electronic payments system. Even Brazil is trying to make the lives of companies a little easier with a digital bookkeeping system that integrates three layers of government to simplify tax compliance tasks.

The procedures that are proven winners at home may not be relevant in other jurisdictions

But while such initiatives are welcomed by globalization SMEs, they can only alleviate the job of meeting multiple compliance requirements around the world. Given this, the more practical option may well be to face up to this and try to seek some benefit from it. “Without a doubt, virtually all countries will present some kind of challenge and risks,” says Mackenzie. “But if a company understands them, it can turn challenges and risks into an advantage by structuring the right kind of finance from the outset.”

70%

Proportion of Ukrainian companies with turnover of between US$625,000 and US$4.37m that reported being targeted by tax audits.
Management | IT governance

Technologies matters

The focus on standardized business processes – particularly in finance and tax – provides a significant opportunity to create vastly more efficient global compliance and reporting processes. But many companies lack a consistent view of their data.

According to results of a recent Bloomberg survey, leading financial technology executives say they want innovations that allow them to process more data more quickly, cheaply and reliably. Of respondents, 84% said they have increased spending on regulatory and compliance systems in the past two years; only 5% had decreased it.

By Clint Witchalls

A recent survey conducted by Ernst & Young, Seizing the opportunity: Global Compliance and Reporting, found that many large organizations do not standardize their processes and systems for global compliance and reporting (GCR). Almost two-thirds say that they lack standardization of tax provision preparation, and nearly one-half lack standardization of statutory accounting and reporting. Clearly, getting a consistent view of data is a challenge for many multinational.

A common cause of this problem is weak IT governance. In many organizations, different functions each use their own definitions, formats and systems, and do not consider the needs of other parts of the business. This creates multiple, disparate data streams flowing to management and to risk, finance and tax functions. In turn, this makes it very difficult for companies to gain the firm-wide view that has become so critical to the success of their GCR activities.

Companies that have grown by mergers and acquisitions face particular challenges. Although systems integration is usually discussed during the due diligence stage of an M&A deal, it does not always happen. Companies often find the task too complex, too expensive, and building workflows to enable the flow of information without fully integrating the systems from the two merged companies. The financial turmoil of the past five years has also resulted in many post-merger systems integration projects being put on hold. Even where systems integration occurs, tax is rarely thought of.

A third cause of poorly integrated finance and tax systems is that executives from the tax function are not consulted during big systems implementations. In the past decade, most large organizations have implemented an enterprise resource planning (ERP) system. But as Albert Lee, leader of Ernst & Young’s EMEIA Tax Performance Advisory team explains, tax professionals are often left out of the conversation.

“People may get tax people involved late in the first implementation, but then find that they are again forgotten for the second window implementation or the finance transformation project or the post-merger implementation,” he explains.

Data is king

Effective GCR begins with that most basic element: data. Unfortunately, this is frequently where things go wrong. Data follows the IT principle of GIGO: if you put garbage in, you get garbage out. It’s a problem that Christine Oates, EMEIA Leader for Quantitative Services at Ernst & Young, has seen many times before.

“When a client records expenditure in their books, they’re not doing it with tax in mind,” she says. “They’re doing it to get an accurate picture of what they’re spending in order to generate revenue. So, when a set of accounts is prepared, they’re typically not fit for purpose for tax. The tax arena is so fast changing and purchase ledger clerks are often not sufficiently knowledgeable about tax to ‘tax-sensitize’ the projects being put on hold. Even where systems integration occurs, tax is rarely thought of.”

Having joined- up IT systems that share a common data dictionary improves efficiency and improves accuracy. Rather than have different functions working with separate data, an integrated GCR system enables a common data architecture to be put in place, which cuts down on duplication of effort and ensures consistency across the organization. This requires focusing on the source data: ensuring that it is captured once (not across multiple systems) and correctly validated.

Many organizations focus on the efficiency of getting information from the system to the end compliance form. While single-click tax returns and single-click provision calculations are a boon, they do little to guarantee that the underlying data is accurate. Erroneous data may be processed faster with these systems, but it will still be erroneous. A bigger concern than inefficiency is non-compliance and the resulting risk to corporate reputation. No organization wants to be on the front page of a newspaper for non-tax compliance. “In an environment where we’re looking for good corporate citizenship, achieving cost savings through more efficient systems and processes pales into insignificance when compared with the reputational damage of non-compliance,” says Lee.

Establishing responsibility

It is important that the finance team lead any projects to create an integrated GCR platform. The individual with overall responsibility is typically the group chief accountant, or sometimes the chief financial officer. But the finance function cannot run the project alone. It should also ensure that the tax function is involved at all stages of the project, and work closely with the IT function and shared service center to achieve a smooth implementation.

As the leader of the IT function, the CIO is responsible for executing the GCR project in accordance with good systems diligence. Although they will run the day-to-day implementation of GCR systems on behalf of finance, it is important to ensure that the tax and reporting requirements are properly understood and built into the design. As our research shows, this is something that is lacking in many GCR projects.

Project infrastructure costs to consider

GCR projects often form part of larger finance transformation programs. One reason for this is cost. It is generally more expensive to build a GCR project in isolation than to fold it into a larger finance transformation project. This is because there are pre-existing IT infrastructure costs, like IT and project management, to consider. Moreover, it would be difficult to build a business case for such a standalone project without reusing the broader organizational benefits of a larger finance transformation project. “When tax is included in broader transformation projects, the incremental benefit is relatively immaterial,” says Lee.

Once the finance transformation project is complete, processes will be standardized and the organization will have moved to a single ERP platform and possibly implemented a shared services center. But this is not the end of the journey. About 80% of the functions that were previously performed locally - accounts receivable, accounts payable, general ledger and tax - will be centralized, leaving about 20% of compliance and reporting taking place locally. Organizations need to configure their enterprise system with a parallel set of books for local tax submissions. Only when this final part of the technology puzzle is in place, will organizations have the broader comprehensive record-to-report system.

The rise of electronic systems in government

Making tax compliance easier

According to the World Bank’s Doing Business 2012 report, creating a more efficient tax administration can help businesses grow, as well as boosting overall economic growth. The report highlights how this can expand a country’s tax base and increase tax revenues. In the past seven years more than 60% of the 183 economies covered by Doing Business implemented some degree of change, with an overall aim of simplifying their tax administration – especially in areas where Internet access may be limited. But widespread efforts are underway in a range of countries, including Australia, Bangladesh, and the UK.

By 2010, 66 economies had fully implemented electronic filing and payment of taxes, for example. According to the World Bank, a total of 10 OECD countries have now made electronic filing and payment mandatory.

This trend is likely to continue, not least as governments bolster efforts to widen their tax take. In the coming years, a number of other economies within the OECD are expected to introduce requirements for electronic filing and payments for larger businesses, which will later be expanded to cater for small and midsize ones.

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In-house or outsourced?

How firms are rethinking the right blend of internal and external talent to cater for their global compliance and reporting needs.
As tax departments face shrinking forces and increasing demands on their time, many seek the benefits of centralization, economies of scale and global talent management, particularly with respect to compliance. But this shift, which typically involves scaling back in-country tax expertise, creates new risks and challenges because tax is inherently local, and the need for local resources only continues to grow as tax authorities become more aggressive about increasing revenues.

A few very large companies have the scale to justify in-house expertise for each jurisdiction in which the company does business. For others, outsourcing or co-sourcing can be a viable, scalable and cost-effective way of better meeting the needs of both in-country compliance and the business as a whole. But what are leading companies doing to identify the optimal mix of internal and external resources?

Local expertise is key
Multinational companies utilize a variety of finance operating models. Some still operate a traditional country-based model, but the trend is for companies, particularly those that have been through a finance transformation, to adopt the use of shared services centers (SSC) and/or centers of excellence (CoE) to obtain the benefits of centralization of compliance and reporting.

“Generally, what you drive to a shared services center is anything you can standardize,” says Steve Schultz, Global Director for Global Compliance & Reporting (GCR) Services at Ernst & Young. He notes that, while there might be elements of local compliance that lend themselves to standardization, for the most part—particularly in developing markets—compliance and reporting requirements are inherently local. There are local tax rules, local regulators and local enforcement.

Taxpayers still need to build relationships with key local tax authorities to establish credibility, collaboration and a compliant reputation.

“One person on the ground needs to understand local tax authorities’ approaches and focus areas and proactively address potential issues. So having an appropriate level of local expertise, knowledge and understanding—‘feet on the street’—whether accessed either in-house or externally or even a mix of both is critical, no matter how a company’s GCR model evolves,” says Schultz.

Yet, as companies undergo the shift to a centralized GCR model, they may reduce the number of experienced tax resources available in-country. In some cases, their former resources are shifted to the SSC or CoE or outsourced to a local service provider. In other cases, some local responsibilities are moved to the remaining local finance people. Either approach presents GCR risks to the extent that local tax expertise is diluted. For example, when responsibility for local tax compliance is shifted to remaining in-country local finance people, “that creates a potential knowledge gap in tax compliance and reporting,” says Christine Oates, Ernst & Young’s EMBA Leader for Quantitative Services.

Schultz notes that, while many companies prefer to retain local tax compliance and reporting, “it’s important to start on the right foot with respect to a company’s expectations and the way in which they want to work. What’s going to be effective in terms of communication? What is the level of reporting you want to see and in what format? How often do you want to see it and in what form? How often do you want to have steering committee meetings?”

Change management is another issue that needs consideration, particularly for companies moving from an in-house model to more of an outsourced model, says Barnett. “For example, how will the company communicate that to its local entities? Is there a plan for that? Is there also a headcount reduction going on, perhaps as part of a finance transformation? It’s important to make sure that, before headcount reductions start, there’s a plan in place to do a full knowledge transfer to the service provider.”

A good mix
How companies manage their compliance and reporting obligations is today at something of a tipping point. This is due to a confluence of business, finance and regulatory requirements coupled with the increasing demands of local authorities. As a result, leading companies are now stepping back to look at their GCR strategies and reconsider when and how they team with service providers to provide effective access to skilled local resources, a key element in achieving a successful GCR outsourcing model.

“Replacing a patchwork of local service providers with a global or regional provider can achieve a greater level of quality and consistency in the service they receive, increasing the level of global oversight,” says Barnett. “No matter how a company does it or who does it, fundamentally, a company needs strong governance and to be sure around its compliance and reporting requirements, who’s doing it, and what the status is,” says Schultz.

Compliance and reporting is increasingly a boardroom issue and finance and tax executives have to be ready to demonstrate that they have visibility and control over their GCR obligations. And the evidence in this area shows that effective sourcing plays an essential role.

**Assessing the true cost of compliance**

Effective resourcing decisions require that companies understand the real cost of compliance. “This requires a company to understand current compliance responsibilities,” says Oates, “and what workflow might be brought in-house or in existing service providers. If resourcing arrangements are changed. Otherwise, a company may lose a lot of work, providing the information that the outsourcers use.”

In a more effective process, the right use of technology to “tax sense the data”, and assistance from the outsourcer to further take the data the last mile, can really save them time, not just move it around.

Another element in assessing the real cost of compliance is the amount of value that specific external providers can offer. For example, Oates, “We see a lot of outsourcing processes run by procurement where the major decision criterion becomes price. The company may get good quality returns from a technical perspective, but not necessarily early feedback about what the provider is seeing in the tax returns or flagging of risks or value-added ideas.”

Resourcing decisions also need to consider whether the company’s global compliance structure provides effective visibility and oversight over issues such as the timeliness and accuracy of filings and payments, identification and management of compliance risks and controversies and cash flow implications of tax payments. Two questions companies should ask as they evaluate outsourcing options are that what are the costs associated with the risks of inadequate visibility and oversight? And how could effective outsourcing mitigate those risks?

For example, says Schultz: “Ideally, companies find they have too many providers and it’s administratively burdensome for them to manage.” Replacing a patchwork of local service providers with a global or regional provider can achieve a greater level of quality and consistency in the service they receive, increasing the level of global oversight.

**Working effectively with service providers**

Regardless of the specific activities outsourced, a successful outsourcing model begins with clear expectations before signing a contract. “It’s very good practice to have a service level agreement in place that clearly defines the scope of services and key performance indicators so that there are no misunderstandings,” says Fiona Barnett, leader in Ernst & Young’s EMBA Global Compliance & Reporting Center. “Companies should also think about what the escalations path should be if issues come up.” She also notes that, to the extent companies understand their internal processes and can document them, or can visualize their processes in new ways, the process to work in the future, the transfer to an outsourcing provider is facilitated.

Barnett also points out that, because the typical contract is for a sustained period of time, “it’s important to start on the right foot with respect to a company’s expectations and the way in which they want to work.”

**Summary**

Corporate efforts to transform finance functions have seen the composition of tax teams change, not least as core functions are centralized into regional teams. But in order to retain local expertise, companies are now exploring a range of hybrid options.

**Source:** Ernst & Young
The importance of external relationships

Strong relationships with regulators and investors can help companies to navigate a challenging environment. By engaging proactively with external stakeholders, businesses benefit from greater certainty and an earlier resolution of tax issues.

By Rob Mitchell

Companies today face a barrage of pressure from external stakeholders. Tax administrations around the world are clamping down and sharing information with each other. Activist investors are on the prowl and seeking stronger justification for business decisions. And regulators are becoming more intrusive and requiring ever-more rigorous compliance documentation.

Faced with these mounting pressures, companies cannot afford to get their stakeholder communications wrong. They must think carefully about how they report and comply and ensure that they engage with external stakeholders on crucial issues. This helps to provide greater certainty and clarity over their compliance and will ultimately lead to better long-term relationships with investors, regulators and tax administrations.

New regulatory requirements

A changing and more complex regulatory landscape has made compliance a highly challenging task. At a time when governments around the world are facing severe problems with public finances, the collection of tax revenues has become an issue of paramount importance. Tax administrations are growing and strengthening their assessment and audit capabilities. New international agreements are prompting increased disclosure and forcing tax administrations to work more closely together. No wonder, then, that in recent research conducted by Ernst & Young, almost two-thirds of respondents said that new regulatory requirements would impose significant changes in compliance and regulatory processes.

Globalization is another major driver of complexity. As companies focus on expanding their market reach, particularly in rapid-growth markets, they expose themselves to new risks and obligations. “Companies are expanding into new and emerging markets, many of which have very different, more inherently local, compliance environments,” says Steven Shultz, Ernst & Young Global Director of Global Compliance & Reporting Services. “Companies going into China, for example, will find a lot of compliance will depend on relationships with local subregional regulators, or at a city level, or, indeed, part of a city.”

At the same time, there is a trend to delocalize the accounting and finance competencies, as today’s technologies and processes allow companies to standardize across borders. This can mean moving to a shared service center, for example, or operating through regional finance centers, or outsourcing the more commoditized aspects of the finance function to an external provider. This can create a tension between global and local. “On a global level, you have the governance and accountability, but the real expertise and the relationships with regulators lies at the local level,” says Schultz.

Maintaining these relationships, even against a backdrop of broader finance transformation efforts, is critical. By engaging proactively with external stakeholders, companies can benefit from greater certainty, reduced compliance costs and an earlier resolution of tax issues. “If you do it smartly, you can identify a wide range of opportunities,” says Schultz. “These could include a more efficient way to come to an agreement with the regulators, ways to leverage your financial systems and data and reduced manual intervention.”

A lack of clarity

This move to broader stakeholder engagement is part of what CB Bhattacharya, E.ON Chair Professor in Corporate Responsibility at the European School of Management and Technology, describes as a sea change in relations between companies and their stakeholders. He points to a shift from an “us” versus “them” mentality to one that is built around a more aligned and cooperative relationship. “Stakeholder engagement is an area that is evolving,” says Anthony Fitzsimmons, Chairman of Reputability, a consultancy that specializes in reputation and crisis risk management. “Today, it’s not just a matter of communicating with stakeholders. It’s

Summary

A complex and fast-changing tax policy environment requires companies to build and maintain effective relationships with stakeholders. In some cases, a more cooperative and aligned relationship is starting to emerge.

Ryan Smith

“Getting a complete picture of your compliance situation is an ongoing challenge,” says Ryan Smith, Vice-President of Global Tax at VF Corporation, a leading branded lifestyle apparel company.
also about understanding how stakeholders see you. And that’s not always very easy for an organization to do.”

Many companies struggle with stakeholder engagement, according to the survey and reporting obligations worldwide. “Many leading companies are putting in place strong governance and a global project management approach,” he explains. “In this way, internal stakeholders can see at a glance what the company’s obligations are, the status of those obligations and where enforcement is needed.”

Ownership of different responsibilities needs to be defined and communicated so it is clear who owns the compliance agenda and who should represent the company both with internal and external stakeholders. “You need to make an inventory of these requirements, monitor changes and then react in time,” he says.

Relationships with tax administrations are more important than ever. At a time when the tax policy environment is increasingly fluid, companies must ensure that they understand the implications of new changes and ideally anticipate them. This is particularly important given that situations can arise when changes to the tax environment can have a negative commercial impact in ways that were unintended by policy-makers.

“Dealing with the possibility of tax impeding long-term commercial planning, companies are increasingly seeking to work collaboratively with government to try to explain the implications of pending change,” says Schultz. “This proactive approach makes it more likely that alternative, well-thought-out policy choices can be made in a way that is comfortable for both business and tax administration.”

Proactive relationships with local tax administrations can be beneficial, but there is no doubt that this can be a time-consuming process. “Multinational companies may be managing thousands of cases across multiple years, and across multiple accounting and compliance processes,” he says. “This complicated process makes it even more likely that alternative, well-thought-out policy choices can be made in a way that is comfortable for both business and tax administration.”

Relationship with the board

As the group that is charged with overseeing management on behalf of the shareholders, the board is another key stakeholder with which companies should engage. In the past decade, regulatory change such as the Sarbanes-Oxley Act in the United States has deepened the responsibilities of the board and ensured that non-executives are increasingly asked searching questions about compliance. “This has made it much more likely that the board will raise the question of who is in charge of global compliance and reporting,” says Schultz. “Ten years ago, some boards just wouldn’t have paid much attention to it at all, but today, even the most well-considered boards would be regarded as a management responsibility.

That’s why it’s very important to have a well-thought-out communications plan with the board of directors.”

75% According to a recent survey from Ernst & Young, the 2013-12 tax risk and controversy survey, three-quarters of tax administrations say that they are moving their organization towards an “enhanced relationship” model with corporate taxpayers.

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84%

According to the survey, about two-thirds of respondents experienced unplanned tax audits, and almost half received unexpected tax assessments or penalties.

50% Each year, regulatory change and tax combat mean that companies are increasingly seeking to work collaboratively with government to explain the implications of pending change.

1.5% An average of one in every 66 companies surveyed regarded it as a management responsibility. This is particularly important given that situations can arise when changes to the tax environment can have a negative commercial impact in ways that were unintended by policy-makers.

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Risky business
Multinational companies face an increasingly difficult compliance challenge when it comes to managing their exposure to various kinds of tax concerns.

> By Rodrigo Amaral

With governments hungrier than ever for revenues, tax authorities are under pressure to raise as much money as they can from both individuals and companies alike. From the US to the United Kingdom, tax administrations are bolstering the ranks of their tax auditors, to help boost revenues and plug soaring deficits. Taxing the rich is a popular theme for the headlines, but companies, in particular, present a compelling target. According to Ernst & Young research, 64% of multinationals experienced unplanned tax audits in the past year, with in 4 in 10 incurring penalties.

Managing this compliance risk can be fiendishly difficult, especially with regard to tax as a result. All this makes tax compliance an increasingly important risk for firms to manage. Clearly companies can’t avoid such scrutiny, nor can they determine when they might be put under the spotlight. This makes it imperative that they are not caught unawares. But this isn’t always easy, especially for firms spread across numerous countries, with different rules and varying degrees of complexity associated with those. This challenge is also being exacerbated by an increase in cross-border cooperation among tax authorities, where non-compliance in one jurisdiction can, in turn, generate an inquiry in another.

Managing this compliance risk can be fiendishly hard, especially with regard to tax. To give just one example raised at a recent tax conference in Stockholm, consider the global insurance industry. One key question for complex insurance policies is about where relevant taxes on such policies should be collected: in the country where policies are purchased, or in the location where losses are registered? Finding a definite answer that fits all situations, and countries, may well be impossible. But this does not prevent national authorities from applying their own interpretation of insurance tax laws. “We all know that the regulatory authorities are looking for scapegoats,” noted one risk manager, from a major European insurer, at the recent Stockholm conference. But a failure to comply is not acceptable: “Any breach has the potential to damage us financially and reputationally.” To compound the problem, the rules that companies need to comply with change all the time. Risk managers often complain that they receive conflicting signals from varying authorities, making it often impossible to be sure that their companies are compliant, no matter how hard they try. Brazil gives just one example. It started opening up its insurance market in 2008, but recently implemented new legislation for reinsurance that partially reverts its only recently adopted stance. This just adds to the country’s already difficult reputation as a challenging tax environment, ranked 150th out of 183 countries by the World Bank.

A taxing risk
Tax compliance can make or break a global insurance program, which is an essential tool for companies to engage in international ventures. But buying insurance is only one of many activities that generate tax risk for firms. Martin Rabenort of Ernst & Young in the Netherlands, notes that corporate tax functions are actually being given more areas to worry about, with VAT, customs and excise duties and other issues increasingly coming under their control. None of this is easy. “If you are transitioning making process, says Redding. As such, decisions are often made without a full appreciation of the compliance and reporting requirements, which creates risks for the company. “If there is a requirement to provide information to the tax authorities and regulators, global compliance and reporting (GCR) teams are often left with a massive burden to find out how that information can be collected and reported,” he says.

Juggling all this, while ensuring readiness for potential audits, requires an organized and well-documented GCR team – and not just in local offices, but globally. To do so, Rabenort recommends applying global standards across all international units, dictated by the head office GCR team, with guidelines, roles and responsibilities clearly defined for worldwide offices. Even though compliance and reporting rules vary widely from country to country, the use of common processes at least boosts the chance that the right information will be found in the case of tax audits.

There is more demand on the tax department, but the scale of their teams is not always appropriate

All things considered, the best possible approach to tackling compliance risks is simply to do things correctly and to be transparent about it. Judith Freedman, a Professor of Taxation Law at Oxford University, points out that, in some countries, the tax authorities are encouraging this kind of behavior by showing a willingness to engage with corporate tax departments. “In the Netherlands, they are trying to promote an exchange of information with businesses whenever they can,” she says. “And companies are choosing to be more cooperative in order to avoid being audited.”

11,511
Number of new EU regulations issued between 2006–2010, according to EUR-Lex.
Engaging with stakeholders to create value

In the past, the relationship between the company and its stakeholders was largely one of “us” versus “them.” Companies were selective about how they communicated with stakeholders, and stakeholders were sceptical of the information they received. But this is changing. As demands for increased transparency from a wide variety of external stakeholder groups increase, companies recognize that this relationship must evolve into one that is more aligned and cooperative.

This new “stakeholder centrity” means that companies now see their stakeholders as part of the same team. Rather than always prioritizing short-term profit maximization, companies are incorporating multiple stakeholder views into their decision-making. My research reveals that this stakeholder engagement, when aligned and at the heart of a company’s strategy, can enhance social as well as business value. It also protects, and indeed, enhances a company’s reputation, which is an essential asset in today’s competitive marketplace.

The first principle that companies need to take on board is that stakeholders matter. This requires them to go from an inside-out view of the world – where the company is at the center and dictates strategy to the various stakeholders – to an outside-in perspective. In this latter approach, companies actively engage their stakeholders. They listen to them, seek feedback and suggestions and, to the extent that is possible, incorporate those views into their decision-making.

This broader stakeholder view requires companies to rethink what is meant by compliance. Stakeholders are no longer satisfied with companies that do the bare minimum and simply meet their obligations in a strictly defined legal sense. Increasingly, they expect companies to consider compliance more broadly and do what is right, not just what is required. According to this view, compliance is not just a box-ticking exercise but the bedrock of corporate responsibility initiatives. And it is not just tax authorities and regulators scrutinizing compliance; investors also want companies to show that they are good citizens and prepared to set standards within their industry. Relationships with all stakeholders need to move from being purely transactional to become more embedded and engaged. In the tax arena, for example, enhanced relationships with tax administrations, which are based on transparency and trust, can be considered a good example of this process. These relationships need integrity and goodwill from both sides to succeed, and will take time to develop. But they enable a far more efficient and effective way of engaging with stakeholders than a purely transactional approach.

Placing stakeholders at the center of the business takes determination from executives to make it happen. It also has significant cost implications. Employees must be trained, and new systems and processes need to be implemented. The benefits will not be immediate – in some respects, these are initiatives that are at loggerheads with short-term profit maximization and beating analysts’ forecasts. Stakeholder engagement inherently requires a longer-term perspective that does not pander to these more immediate pressures.

This highlights the importance of leadership. Senior executives need to be able to bring staff on the journey with them, as none of this can happen without engaging the internal stakeholder group to embrace this new approach. They also need to put in place metrics to determine whether the stakeholder engagement is working or not. There are dozens of metrics that companies could use on an ongoing basis to assess the effectiveness of their strategy. For example, companies may want to measure stakeholder identification with the company or the perceived reputation of the organization.

Finally, companies need to respond to the feedback from their stakeholders. This cannot be approached in a half-hearted way. If you tell stakeholders that you are going to take action and then you don’t, this gives them the message that they are wasting their time. Leaders have to commit to respond and, if they can’t take action on the basis of stakeholder feedback, they need to explain why. Stakeholder engagement is a powerful philosophy, but it can only be effective if both sides play their role.

By CB Bhattacharya, Professor at the European School of Management and Technology, Berlin

Biography
CB Bhattacharya is the E.ON Chair Professor in Corporate Responsibility at ESMT European School of Management and Technology in Berlin, Germany, and Dean of International Relations. Previously he was Professor of Marketing at the School of Management at Boston University.
CB Bhattacharya is the co-author of Leveraging Corporate Responsibility: The Stakeholder Route to Maximizing Business and Social Value (CUP, 2011).
Global M&A tax survey and trends
Our second annual review of trends affecting the tax aspects of corporate mergers and acquisitions (M&A) details the increasingly critical role that tax directors play in identifying and delivering on the promised value.

Seizing the opportunity in Global Compliance and Reporting (GCR)
GCR comprises the key elements of a company’s finance and tax processes that prepare statutory financial and tax filings as required in countries around the world. In this publication, we examine best practice in managing and coordinating these vital activities.

50     T Magazine

Current tax issues, as well as detailed and practical advice on rapidly evolving tax policy, help companies keep pace with a briefi  ng is aimed at helping Ernst & Young’s quarterly

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