TAX

Good, Better, Best

Diversified Industrials

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Introduction

For the KPMG network, a top priority is helping member firm clients manage tax transformation and position their businesses for future success. Since 2006, we have conducted regular surveys of tax executives around the globe to uncover their most pressing issues. Our purpose is to gain insights on how these issues influence changes in structure, investments in people and processes, and overall objectives and priorities.

Now, in this updated survey conducted in late 2012, the environment in which tax directors operate has changed dramatically. Lingering economic uncertainty is increasing pressure on companies to cut costs and on tax authorities to boost revenue. Globalization continues to spur centralization of finance, tax and other functions. Companies are expected to improve their governance, accountability and transparency in all areas. Further, political attitudes toward taxation are shifting, with much more focus on civic responsibility and public demands that companies should pay their "fair share" of tax to the jurisdictions where they earn profits.

With this environment as a backdrop, we sought to identify trends and benchmarks on the following fundamental questions:

- How are tax departments changing their operations to address emerging economic, business and regulatory trends?
- How are they progressing on aspects of governance and performance such as strategy, risk management and measurement?
- How are they approaching process and technology investment and improvement, including the impact of cloud computing?
- How are they addressing the pressure to more effectively resource how they do their work?
- How are they responding to rising tax authority scrutiny and demands?

The survey now shows that tax departments have made good progress in several of these key areas. However, in a rapidly changing business and regulatory environment, the results also suggest that there is still work to do if tax departments are to meet the dual challenges of effectively managing risk while providing more effective, real-time support to business activity.

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Focus on Diversified Industrials Companies

Based on KPMG International's survey of tax executives, tax departments of multinational companies in the Diversified Industrials (DI) sector are:

- **Gaining more interest and guidance from boards and corporate leadership** in the development of tax department strategies that align with the company's overall business strategy.
- **Facing higher levels of tax controversy than companies in other industries,** especially in the areas of corporate income tax, indirect tax, yet transfer pricing, due to their regional operations and supply chain structures.
- **Less likely than their peers in other industries to use outsourcing and co-sourcing** to carry out or support tax department activities, partly to protect proprietary knowledge and reduce costs, yet perhaps missing opportunities to free in-house tax resources for other, more strategic pursuits.
- **Putting more emphasis on compliance-related activities than on other, more strategic activities,** such as improving connectivity with other parts of the business.
- **In need of further investments in improving processes and technology** to keep pace with rising tax compliance audit demands while freeing tax department time to engage in other pursuits that add value and influence the bottom line.

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KPMG's series of benchmarking studies of tax department structures and operations shows that leading tax departments – those that add the most value to their businesses – do so by putting high priority on three areas:

1. ensuring clarity of accountabilities
2. driving standardization and efficiency
3. promoting connectivity with their colleagues across the business through a proactive, outward-reaching tax department.

In conducting the survey in late 2012 on behalf of KPMG's member firms, we were keen to see how tax departments have progressed in these areas, especially given ongoing economic uncertainty and continuing regulatory reform.

This report highlights insights on how tax departments of companies in the DI sector have advanced since our last survey in 2009. For analysis of the global survey results, visit kpmg.com/goodbetterbest.

Clarifying of accountabilities – boards more engaged in tax matters

With minimal growth expected over the next 2 years, global DI manufacturers – which includes aerospace and defense, metals, conglomerates, engineering and industrial products – are focusing on innovation, improving efficiencies and cutting costs. Many DI companies are following the trend toward near-shoring, by diversifying their manufacturing geographically and regionalizing their procurement functions. DI companies also are focusing on operational improvement by optimizing their inventory, transportation, logistics and other operational costs.

With increasing regionalization and supply chain complexity, improving risk management is a top priority. The prevalence of regional manufacturing and shared service center arrangements in the sector raises transfer pricing risks over intellectual property rights and allocations of functions. Similarly, high volumes of cross-border transfers raise issues related to value added taxes/goods and services taxes (VAT/GST), and customs duties.

In this context, it is not surprising the tax governance is rising in priority for boards and corporate leadership of DI companies. As part of such oversight, previous KPMG tax department benchmarking studies have shown that leading tax departments put priority on ensuring tax department's roles and responsibilities are clear and commonly understood within the context of a company-wide, board-approved tax governance framework.

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Survey results show that boards and corporate leadership of most DI companies are clearly focused on the management of tax. Almost all DI respondents (93 percent) say their company has a tax department strategy that is consistent with the company's overall business strategy. For 73 percent of respondents, the board and/or corporate leadership are directly involved in providing guidance on the tax strategy. Similarly, 76 percent of respondents report that their board has approved the tax strategy.

Compared to respondents from other industries, more DI respondents say their boards and/or corporate leadership has approved their approach to risk management (83 percent versus 75 percent for all industries). However, DI respondent companies are less likely than their global counterparts in other industries to document their tax department and risk management strategies, which is important for ensuring strategies and policies are followed: 57 percent of DI tax departments have formally documented their tax strategy, compared to 62 percent overall, and 66 percent have formally documented their company's approach to managing tax risk, compared to 71 percent overall.

Survey results suggest that DI tax departments' primary focus is on day-to-day compliance work. DI respondents say that accurate and timely tax return compliance is the most important activity driving tax department objectives, followed closely by accurate and timely financial reporting and tax risk management. These are the top three most likely activities to have KPIs assigned to benchmark and measure tax department performance.

DI companies, unlike many of their industry peers, manufacture and distribute tangible goods and more 'visible' to tax authorities. Accordingly, 68 percent of DI respondents say they are involved in some form of tax controversy:

- 26 percent are involved in disputes involving customs/duties (versus 19 percent for all industries).
- 37 percent are involved in disputes involving transfer pricing (versus 26 percent for all industries)
- 39 percent are involved in indirect tax (sales/use or VAT/GST) controversy (versus 33 percent for all industries)
- 40 percent are currently involved in federal corporate income tax controversy (versus 34 percent for all industries)

DI respondents see tax authority focus increasing in the above areas in future and thus controversy activity could rise further.

93%
of DI respondents have a tax department strategy that aligns with their overall business strategy

73%
say their board or corporate leadership provided direct guidance on the tax strategy's development

68%
of DI tax departments are involved in some form of tax controversy

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Driving efficiency – tax process & control improvements

As DI companies diversify their manufacturing geographically and regionalize their supply chains, the reporting structures of DI tax departments become more complex. These reporting structures differ based on whether the tax employees are responsible for single country reporting versus specific business units or divisions. For those tax employees with single country responsibilities, 42 percent report to a global headquarters tax department and 23 percent report to regional tax personnel.

On the other hand, for employees with specific business units or divisions responsibilities, 47 percent report to the global headquarters tax department and 14 percent report to regional tax personnel. Regardless of the type of tax responsibility, DI companies have more tax employees reporting to regional tax personnel than companies in all industries combined.

Reporting lines		
If you have employees with tax responsibilities for single countries, who do they report to?		
	DI companies	**Companies in all industries**
HQ Tax	42%	47%
Regional tax personnel	23%	14%
Regional finance/accounting personnel	30%	37%
Other	6%	3%
If you have employees with tax responsibilities for specific business units or divisions, who do they report to?		
	DI companies	**Companies in all industries**
HQ Tax	47%	50%
Regional tax personnel	14%	10%
Regional finance/accounting personnel	32%	38%
Other	7%	3%

Given the complexity, a focus on standardization is important for ensuring the tax department's consistent quality and efficiency. Standardization eases the management of complex data flows, streamlines the performance of routine tasks and increases the accuracy of tax data and related filings. Further, it facilitates the use of technology to monitor results and investigate anomalies and helps foster better understanding and communication of tax matters across the company.

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Survey results show that tax departments of DI companies are actively working to make their global tax processes and controls more uniform. Compared to other industries, slightly more DI respondents rate the levels of standardization of their tax controls, policies and procedures as "standardized" or "very standardized".

Responsibilities and accountabilities of tax personnel are the most standardized areas for DI respondents, followed by controls and then learning, development and career paths for tax personnel. In terms of the annual cycle, however, standardization levels reported by DI respondents are closer to global averages regarding annual tax provisions processes, forecasts of tax expenses or tax rates, and reconciliations of annual provisions and returns, and below average for tax compliance and return processes.

As they work to optimize their overall global business structures, the majority of DI tax departments are making investments in improving their tax and finance function processes and controls. For example, 66 percent have process-related improvements in the works, 64 percent are providing better training for existing staff, and 63 percent are conducting, or plan to conduct, overall tax strategy and operational reviews.

DI respondents are less likely than their peers in other industries to use outsourcing or co-sourcing to carry out/or support tax department activities, but they are more likely to use shared service centers. Currently, 30 percent of DI respondents use outsourcing or co-sourcing for these purposes, compared with 34 percent of all industries combined. That said, 38 percent use a finance or accounting shared service center to support the tax department (versus 30 percent for all industries), and 29 percent rely on other finance resources (versus 25 percent for all industries).

Corporate income tax compliance, tax planning and related support to the overall business are the most outsourced tax activities among DI companies. Knowledge retention is considered the most important characteristic guiding decisions over what DI tax department activities to keep in-house, followed by cost.

The preference for shared service centers over outsourcing/co-sourcing aligns with the regionalization of DI companies' broader business structures. Nevertheless, DI companies may be missing opportunities to use outsourcing strategically to free up in-house resources for other activities and to access best practices and investments in people, processes, and technology that cannot be developed in-house.

Promoting connectivity – compliance takes priority

As in other industries, tax departments of DI companies put more emphasis on compliance-related activities than they do on improving interaction with other parts of the business. While compliance is crucial, KPMG International's research shows that connectivity is important for tax departments to achieve their full potential as contributors to business strategy and drivers of value.

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In the next 12 months, DI respondents expect to spend 58 percent of their time to be focused on risk (9 percent), reporting (18 percent), and compliance activities (19 percent), and another 12 percent managing tax audits. However, other strategic activities such as optimizing the effective tax rate and cash tax planning/tax deferral are only allocated 11 and 9 percent, respectively. Integration with business groups and early indication of routine transactions is expected to take up 8 percent of tax department time.

In light of rising tax audit scrutiny and controversy reported by DI respondents, it seems likely that their tax departments will have to devote even more time to compliance and managing tax audits in the future than they do now. As a result, they could soon have even less time and resources to devote to more strategic pursuits.

While DI tax departments are working to enhance their processes and controls, there is less appetite for more fundamental structural improvements. For example, 78 percent of DI respondents believe their administrative budget is sufficient, and only 22 percent expect their tax department structure to change in the near future.

However, there are signs that some proactive DI companies intend to invest in structural changes that may allow their tax departments to contribute more value. Among the planned DI tax department restructurings, improving controls (82 percent), improving efficiency (77 percent) and reducing costs (77 percent) are the top reasons. Further, 68 percent of these changes also aim to better align the tax department with the business or finance function – significantly higher than the average for all industries of 50 percent.

Looking ahead, as tax audit activity and pressure to reduce costs continue to mount, it is likely that DI tax departments will be more constrained in their ability to provide effective, real-time support to business activity and influence the bottom line. By investing in additional standardization, process improvement and tax technology, DI companies will be better able to boost efficiency and keep up with their compliance demands, while improving the ability of their tax teams to collaborate with their peers in other departments and add greater value.

28%
of time would be spent on integrating with the business, optimizing the effective tax rate and cash tax planning/ deferral

78%
of DI respondents say their administrative budget is sufficient

22%
expect their tax department to be restructured in the near future

68%
of tax department restructurings would aim to better align the tax department with the business

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Blueprint for change

As tax departments struggle to cope with mounting regulatory and cost pressures, leading organizations are seeing that a transformational approach can show the way forward. KPMG International's research has distilled the following steps as crucial elements in a tax department's blueprint for change.

1. Establish a **common purpose** by aligning strategic goals and objectives of the tax department with those of the wider company.
2. Define **one view of performance** to monitor effective tax management by clarifying requirements and how performance is measured and valued, through agreed-upon KPIs.
3. Ensure the tax department has **high-performing teams** with the right number of tax professionals and the right mix of training, skills and experience.
4. **Embed processes** to realize the tax management strategy in a way that is measurable and sustainable for the long-term.
5. Set systems and procedures to produce, exchange, and distribute **timely and accurate information** to the right people, at the right time, and in the right format.
6. Employ **enabling technologies** (e.g. enterprise resource planning systems, tax software) to automate labor-intensive processes that consume resources and increase risk.
7. **Influence stakeholders** by understanding their goals and constraints and communicating with them to help achieve the goals.
8. Set processes and priorities and align the tax department's structure to promote **connectivity and collaboration** between tax teams and other departments.

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About the survey

- KPMG International's global survey of people in charge of tax policy and operations of businesses worldwide is one of the largest surveys of its kind.
- Iterations of the survey have been conducted regularly since 2006, charting the evolution of leading tax departments and identifying operational benchmarks for high-performing tax teams.
- For the 2012 survey, 1,150 heads of tax in 22 countries, including 177 respondents in DI companies, took part in blind telephone surveys to share their opinions on how tax departments are adapting to current business challenges. About 700 of respondent companies are Fortune 500, Forbes 2000 or equivalent companies.
- To gain more clarity on the telephone survey results, additional in-depth interviews were conducted with several clients of KPMG member firms and tax professionals worldwide.

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