CFO AND TAX MANAGEMENT, DECADES IN MAKING

CAIUS

Tax Management Solutions

CFO and tax management, decades in making

Lyndsey Zhang, Marc Zaal and Pieter van der Straaten[1]

Introduction

- *As a CFO, how do you evaluate Return of Investment of your tax function?*
- *Can you articulate your company's tax strategy? Is the tax strategy aligned with or supporting your company's business strategy? Do you have a clear picture of tax risks?*
- *Perhaps you know how much time and money is spent on tax compliance, reporting and planning but do you know how the spending is divided between internal and external resources?*
- *Have you thought about the right mix of outsourcing and insourcing of tax functions and more specifically in the context of process optimization and automation?*

A lot of the above-mentioned topics are becoming more and more important to a company's long-term success and sustainability and answering these questions may help CFOs to understand their deeper involvement in company tax matters.

[1] Lyndsey Zhang is a CFO executive and has worked for companies in US, China, HongKong, Singapore, Switzerland and Germany. Marc Zaal has worked as a tax executive for many years in industry in the Netherlands, Poland, Italy, Switzerland and Luxemburg and forms the partnership Caius Tax (In)Sourcing with Pieter van der Straaten who has also worked as a tax executive for many years in the Netherlands, Russia, France and the US.

CFO AND TAX MANAGEMENT, DECADES IN MAKING

Background

Even though tax departments are ultimately the CFO's responsibility, historical data shows that tax departments are used to operating fairly independently as tax specialists were often not able to communicate very technical tax topics with their CFO proficiently, resulting in critical tax issues not receiving the appropriate attention at executive or board level.

Moreover, the tax function was often not part of the prime focus as it is not directly related to operating business, performance management or reporting ("above the line"). Corporate tax however, represents an important expense line in the Company's P&L, which can have a significant impact on the company's key financial indicators like cash flow, EPS, net earnings and market value. In addition, the costs to manage the company's tax compliance, reporting and staffing could represent a large expense for the organization.

Evolution

The tax world, especially the international tax world, has changed. CFO's and occasionally CEO's are held accountable for tax reporting in many countries. Increasingly, financial executives can be held liable for unpaid business taxes with potentially criminal ramifications. Another factor to be considered is public opinion and how it is looking more critically at a company's tax behaviour as part of its social responsibility.

This brings the reputational aspect of tax behavior into the equation and as a result an increasing number of executives and CFOs are starting to realize the importance of their involvement in tax management.

The question of how the tax function should be structured is contemplated frequently. Tax function comes in many sizes and dimensions due to the variety of elements that shape its design. CFOs will need to determine how these elements apply within the broader organization to allow for the design of an effective operating tax function that connects the dots between the company`s overall strategy, financial performance goals, risk appetite, place within the broader community, structure, organization and last but definitely not least, its associated costs.

In this article we would like to outline how CFOs can help the tax function become more successful while contributing to the value of the company.

In the first part of this article we will discuss how your tax strategy can be a useful tool when taking a holistic approach, to help you to connect the dots and to derive a comprehensive proposition for building a tax function appropriate to your business needs. In the second part of this article we will zoom in and take a closer look at some important international developments from a policy-making, technological, and organisational perspective, which may be helpful when considering and eventually executing your tax strategy.

CFO AND TAX MANAGEMENT, DECADES IN MAKING

Tax Strategy

The purpose of a tax strategy is to set out the overall approach of the Group with respect to taxation. Generally, tax strategy entails the company`s approach towards management and control over its tax affairs and the general framework within which the Group will operate when considering tax related issues. It is important that the strategy is known, supported and approved at the highest management levels and therefore should be subject to approval by the Board of Directors on an annual basis. In addition, it will need to be periodically reviewed by the CFO in conjunction with the Group`s tax department or with external tax specialists in the case of companies that don't have their own internal tax department. The tax strategy is mandatory and the approach and behavioral principles described must be followed with respect to:

1. Tax risk management;
2. The group's attitude to tax planning;
3. The group's relationship with tax authorities.

1. Tax risk management

As indicated the Board is probably the most appropriate governance body to be accountable for risk management within a broader control framework. To ensure this, the framework should focus on the following two key areas:

a. Integrity in compliance and reporting

Ultimate responsibility in integrity in compliance and reporting, supporting the governance framework, control and management of tax risk primarily resides with the CFO. Key risks and issues related to tax, including unusual or uncertain tax positions, are escalated to and considered by the Group's Audit Committee and the Board.

Here the role of the CFO lies in the assessment of the adequacy of positions taken before escalation (if any) by the Group's Audit Committee. One important aspect during this assessment is the risk appetite of the Group. In this respect, it may be helpful for the CFO to connect to the accounting reality by applying the "more likely than not" principle, providing a relative, objective measurement standard to determine whether a tax position is allowed under applicable tax laws.

b. Governance – Tax risks control and management

Within the governance framework, attention is not only required for whoever within the Group is responsible for statutory reporting and tax compliance but also for whoever performs the work and ensures a quality review. In many Groups, heads of local finance departments residing within the legal entities are responsible for local tax compliance and tax reporting quality review, with the support of external advisors or an internal tax department. Therefore, from a more operational perspective, the CFO is the ultimate owner of tax risks control and management of the entire group. A Group RACI matrix and periodic risk and control self-assessments conducted internally and by external advisors /auditors may be helpful. The CFO should implement appropriate controls and processes to mitigate identified risks and periodically evaluate areas where potential risk might occur.

CFO AND TAX MANAGEMENT, DECADES IN MAKING

However, in the light of the above, the first thing the CFO may consider is which part of statutory reporting and tax compliance[2] should be done by its internal tax department or finance department and which part should be outsourced to an external tax service provider.

Historically, most of the statutory reporting and tax compliance has been done or supported by local heads of finance departments in their own countries and subsequently consolidated at head office level by Group finance or by the tax department. Some companies hire accounting firms to support the local controllers or they ask outside tax specialists to train them. In this regard, another consideration may be to what extent can the statutory tax reporting and compliance process be standardized and automated internally.

Increasingly, Groups are deciding to outsource all tax returns (including VAT) and transfer pricing documentation to one single service provider with a presence in the countries where the group is active. This may be attractive from a control, efficiency and cost perspective, as the group may leverage from the specific IT-systems, know-how and processes already in place and applied within the eco system of the service provider.

The CFO needs to understand all of the above and strike the right balance between compliance, quality, control, and the cost of outsourcing vs. insourcing.

At the end, tax risks control and management should be focused on ensuring that taxes (and tax risks) are managed to provide outcomes consistent with commercial reality and are within the parameters of the Group’s strategic objectives.

2. The group’s attitude to tax structuring

The Group`s attitude to tax risk may influence the Group`s ETR, cash flow, EPS and overall value of the company.

However, within the boundaries imposed by the recent introduction of international taxation standards (BEPS, ATAD, MLI, etc.)[3] on Group companies over the last 5 years, the appetite for (aggressive) tax planning is to a large extent connected to:

a) Your business model and operating structure, e.g. as CFO you may want to ensure that all tax planning is built on sound business activity and that the economic benefits associated with tax planning arrangements are simple, well-understood and based on best practices.

b) The Company’s integrity and compliance principles e.g. it may be based on the Code of Conduct and its place within the broader community, while taking into account sustainability and continuity of the tax positions taken over the longer term.

---

[2] Income tax compliance involves filing annual income tax returns and compiling annually the transfer pricing documentation, i.e. master files and local files. The master files describe activities of the group and the local file the activities of the local entity. VAT reporting includes monthly or quarterly VAT returns.

[3] OECD’s Base Erosion and Profit Shifting, The European Union’s Anti-Tax Avoidance Directive and OECD’s Multi-Lateral Instrument updating a large number of tax treaties on tax avoidance measure.

CFO AND TAX MANAGEMENT, DECADES IN MAKING

Finally, when planning to meet the Group's standards towards tax strategy, CFOs have to ensure that tax structures are evaluated as objectively as possible by external experts and internal stakeholders. It is important that planning is managed by specialists who are able to balance opportunities with new international rules on tax avoidance, making sure nothing is over-looked, while senior leadership should review the overall strategy with consideration of any potential exposure, which could damage the Group's reputation.

CFOs should help to identify processes to guarantee that the right process is followed for balanced decision making, e.g. who should sign off in the company on the more far reaching planning projects. In addition, CFOs should drive the definition of areas where certain projects need to be signed off by external advisors.

3. The group's relationship with tax authorities

As a Group CFO you may be instrumental in determination of the relationship that the Group creates in its approach towards dealing with tax authorities. Generally, in a world where information about taxpayers is increasingly fluid and more public a CFO may be an advocate for a relationship with tax authorities which is dominated by the principles of openness, transparency and proactivity. For example, the Group commits to:

- Adopt open and collaborative professional relationships with tax authorities.
- Make fair, accurate and timely disclosures in correspondence and returns and respond to queries and information requests in a timely fashion.
- Seek to resolve issues with tax authorities in real time and where possible, before returns are filed.
- Engage in full, open and early dialogue with tax authorities to discuss tax planning, strategy, risks and significant transactions.
- Fully disclose any inadvertent errors in submissions of tax returns and tax computations made to tax authorities as soon as reasonably practicable after they are identified.
- As with any large group, from time to time differences of opinion may arise regarding the application of the tax legislation. Where this is the case, the company will seek to discuss and resolve these in an open, honest and transparent manner with the authorities.

Important international developments

1. The Increasing Tax Compliance Burden

Not only tax laws are changing rapidly around the world, different authorities are also demanding more and more tax-oriented reporting from companies.

Recent examples of this are the introduction of Country by Country Reporting, Group Master File and Local Country File transfer pricing documentation requirements (typically applicable to MNEs with consolidated revenue in excess of EUR 50M) and recently DAC6. [4]

[4] The EU Council Directive 2011/16 in relation to cross-border tax arrangements, known as DAC6 imposes mandatory reporting of cross-border arrangements affecting at least one EU Member State that fall within one of a number of

CFO AND TAX MANAGEMENT, DECADES IN MAKING

- All the above reporting requirements result in new calculations and due to their recurring nature, considerations throughout the tax lifecycle. In this respect a CFO may need to consider:
- Are the right numbers of people working on the most relevant issues and associated computations? Are people strategically located to enable tax efficiency and operational execution?
- Do I have the right skills and capabilities to manage external compliance in this new regulatory environment in addition to internal accounting for new modelling and computational elements that will be required?
- Do I further internalize tax compliance and manage my (additional) costs through driving efficiency up by looking for shared services type of solutions within the broader finance community? Orr do I externalize tax compliance by outsourcing (parts) to third parties realizing my cost arbitration by taking advantage of their specific know-how and scale?
- How could technology be used to face the increased compliance burden and manage its costs? Should technology be built in-house, purchased outright or acquired through some blend of co-sourcing or outsourcing?
- In the current environment, how can we future proof ourselves for change?

2. Increasing risks due to tax policy changes as a result of the increase of business complexity and globalization.

Traditional corporate tax was established either based on the physical location of a company, employees, or delivery of product. With the fast-growing world of e-commerce, digital businesses and globalization, represented by giant companies like Amazon, Facebook and Google, these traditional touch points for levying income taxes have become less relevant.

Tax strategies as frequently applied by companies have been one of the main reasons for the OECD to introduce their Pilar I and II proposals exploring whether companies conducting digital services and/or consumer facing activities can be taxed on profits generated in jurisdictions where users and buyers are located. The OECD have also proposed to introduce a “minimum tax rate” system providing countries with new tools to protect their tax base from profit shifting to countries taxing profits at below the minimum rate.

These OECD proposals provide the global business world with yet another international tax challenge and demonstrate that CFOs should not only understand business practice and the operational structure supporting the tax strategy, but also need to understand and evaluate these rapid policy changes. More importantly, CFOs should anticipate the bottom-line impact within the organization to ensure these changes are embedded, adequately absorbed and implemented throughout the entire organization with proper policies and procedures among all stakeholders.

Finally

Times are changing in the international tax world and the role of the tax department needs to be re-evaluated. Tax departments used to be busy with their own affairs, while struggling to communicate tax to the outside world.

“hallmarks”: broad categories setting out particular characteristics identified as potentially indicative of aggressive tax planning. The reporting obligations fall on “intermediaries” or, in some circumstances, the taxpayer itself.

CFO AND TAX MANAGEMENT, DECADES IN MAKING

Setting risk management strategies, minimizing taxes, anticipating massive tax policy changes, integration of tax and companies' objectives as well as managing tax compliance cost and the decision-making and processes of all the aforementioned make a huge difference for the company's long-term success. CFOs' involvement will facilitate alignment between the corporate tax strategy and business strategy, while being prepared for change. In the long run, CFOs' involvement in the management of the tax department will help establish a more standardized, transparent and global business and tax ecosystem.