Tax Function of the Future series:
A focus on today

December 2017

Spotlight: Tax operating models
Technology disruption in sourcing decisions

Leading-in

The Tax Function of the Future – A Focus on Today series spotlights topics relevant to Tax with a focus on what Tax needs to do *now* to operate successfully in an increasingly complex tax and business environment.

The Tax Function of the Future series predicted challenges and offers solutions that Tax functions may face now or in the future. Our prior papers presented insights on new legislative and regulatory challenges and the resulting impact on risk management; discussed the need for Tax to focus on data analytics and to play an integral role in broader Finance transformation initiatives; highlighted the importance of enhancing income tax reporting processes; and examined critical and rapidly emerging technology trends for Tax—enhanced analytics tools and capabilities, and Robotic Process Automation (RPA). We've addressed important predictions for the Tax professional of the future—focusing on the need to stay relevant, adapting to changing times with new requirements for technology and other expanding skill sets.

In addition, we've offered guidance on developing a business case for change, establishing a tax strategy for success and, most recently, we've discussed the need for Tax key performance indicators (KPIs) in assessing the function's performance.

For more information on our predictions for the Tax Function of the Future, please visit www.pwc.com/us/futureoftax.

In this third spotlight publication, we continue our discussion on Tax strategy assessment with a focus on various operating models that are available to enhance the Tax function from a sourcing perspective. Are tax activities being performed internally or externally through use of a third party? Why would Tax consider a change in approach and what are the drivers in assessing which sourcing method provides the best strategic fit? And, importantly, we will address how ongoing technology disruption in the marketplace influences key Tax sourcing decisions. Finally, we will explain how to get started on a path to the most effective sourcing model for success.

A closer look

The shift to new ways of operating

We predicted that Tax functions would move compliance related activities to shared service centers or engage in co-sourcing arrangements with third-party service providers.

As a result of growing complexity in the function, we've found that Tax has increased its use of shared service centers and co-sourcing arrangements; however, will those models sustain into the future? Current trends in the tax environment are influencing how Tax operates. In fact, new sourcing models have emerged to address Tax's needs. We will review the available sourcing options; however, let's first consider the reasons why Tax would consider a new approach.

PwC prediction

Most global tax preparatory compliance and reporting activities, including data collection and reconciliations, will be performed within the company's shared service centre or will be co-sourced with a third party.

In our most recent paper, *Defining Success: What KPIs are driving the Tax function today*, we discuss the key factors that contribute to an organisation's success. These broad considerations are the basis on which Tax should establish a strategy and goals that can be measured objectively by KPIs:

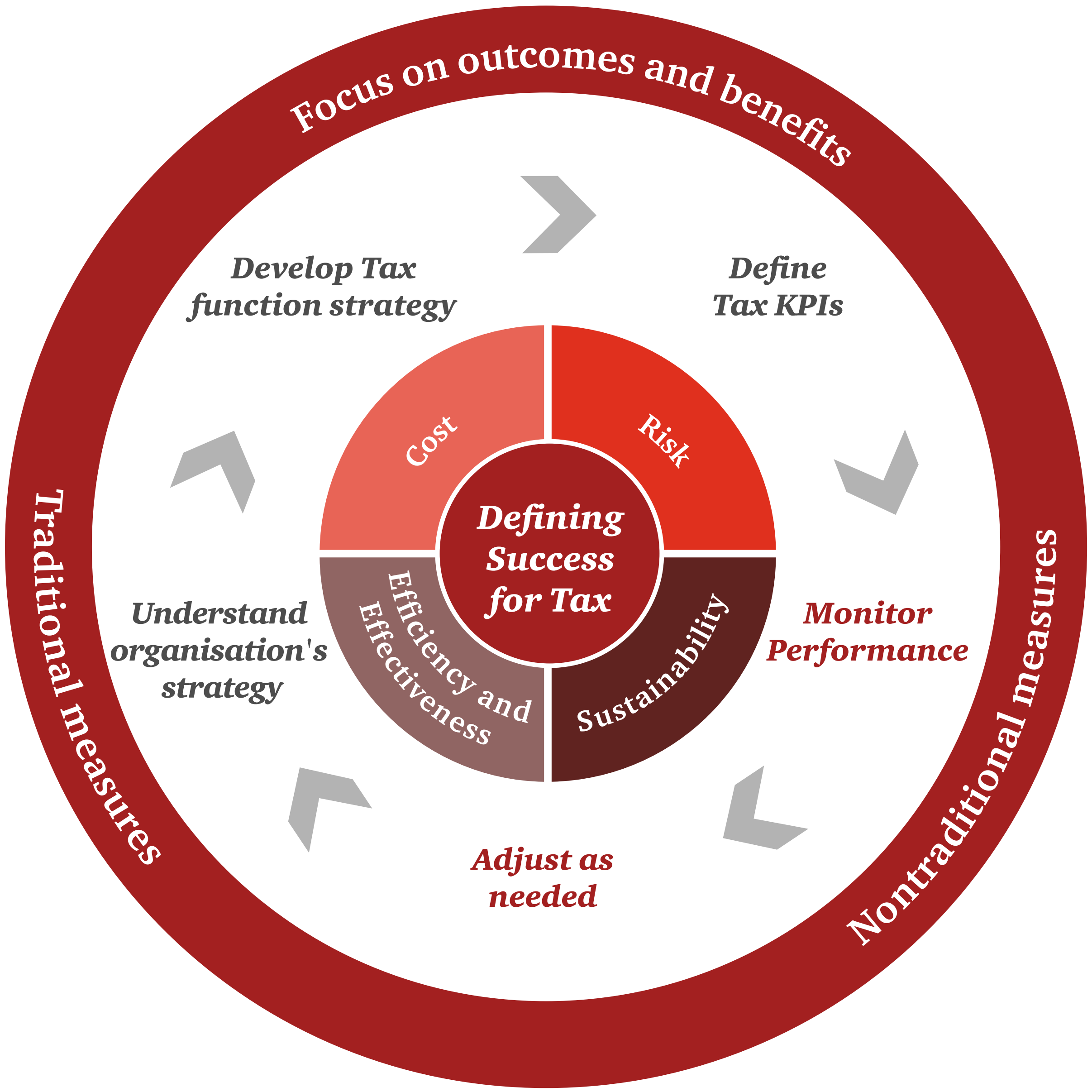
- Tax cost
- Risk (financial and reputational)
- Efficiency and effectiveness
- Sustainability

A closer look

We've also discussed the importance of routinely monitoring performance against established KPIs so that Tax's strategy can be modified appropriately. It is in the process of evaluating performance that Tax may discover that changes are needed in the way the function operates. KPIs may help identify whether, in this rapidly changing environment, a different operating model will improve an organisation's ability to reduce tax cost, risk, and improve efficiency, effectiveness, and sustainability.

The adjacent model describes the process of establishing a tax strategy, defining KPIs, monitoring and adjusting strategy as needed to achieve desired performance.

Tax functions are focussed on reducing operating costs, increasing value, and managing risks – technology has become a critical enabler in this strategy.

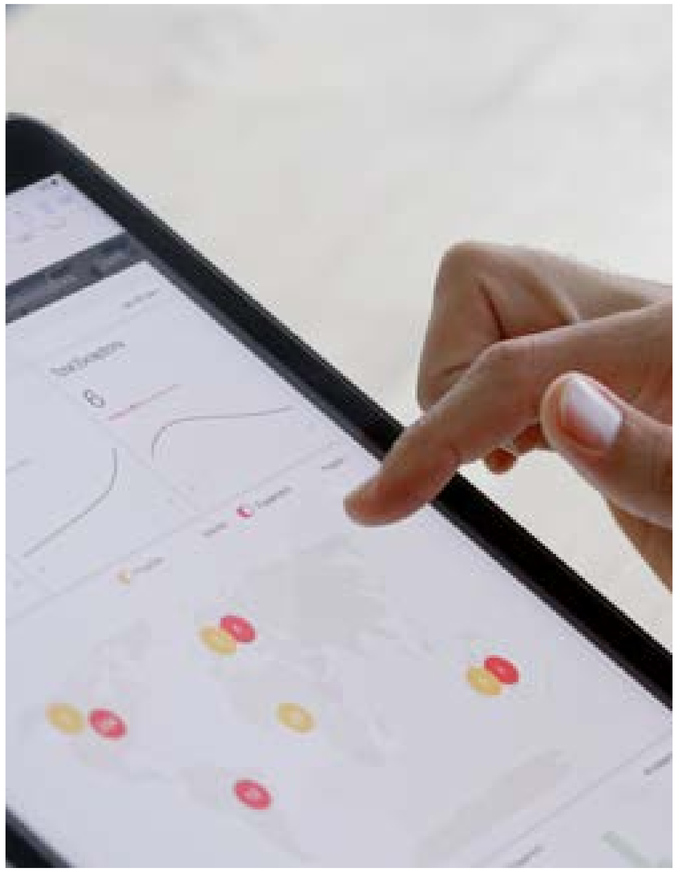


The technology disruption

Where does technology fit in this discussion? The short answer is – everywhere. Technology has permeated our culture and is now an unavoidable consideration in every business and Tax decision. In fact, technology solutions, effectively applied, have the potential to improve performance of every success factor described previously.

Technology and data analytics solutions have the potential to enhance every aspect of the tax lifecycle, from planning to controversy support. Quick access to accurate data for scenario analysis using self-service visualisation tools can provide insights to enable planning decisions. Provision and compliance technology solutions have evolved with capabilities to automate workflow, data collection, calculations, and tax return preparation and filing. Furthermore, advancements in sharing and storage of tax related data have improved the ability to respond in a timely fashion to tax authorities with accurate information. Technology can even improve the way Tax collaborates with other functions through the management of data. Still, there is unforeseen potential in the power of emerging technologies to further revolutionise the way Tax operates.

> *“Technology is the thread that runs through the entire tax life cycle.”*
>
> *— PwC Tax professional (former member of Tax leadership at GE)*



Current tax technology trends

– What are the key drivers affecting sourcing decisions?

Finance transformation – Finance has already taken strides in embracing technology transformation, centralising functions in shared service centers (SSCs) or centres of excellence (CoEs), harnessing the power of significant investments in enterprise data and financial reporting tools, and leveraging cloud solutions for the management of data – the same financial data that is essential for planning, financial statement reporting, tax compliance, and managing controversy risk. Could Tax benefit from leveraging existing Finance technology and infrastructure?

Tax transformation – Tax has focussed on better access to source systems and data with use of self-service tools for improved analytics; however, automation of activities and processes is often limited to certain aspects of compliance or income tax provision calculations. Could Tax benefit from a change in operating model for other functional areas, including transfer pricing, planning, and controversy or use of external resources as a catalyst to process and technology transformation in these key areas?

A closer look

Emerging technologies – Artificial intelligence (AI) and Machine Learning (ML) capabilities, including RPA, are impacting business operations and enabling functions in ways that were not imagined just a few years ago. Should Tax invest in substantial automation of routine, repetitive activities through use of a digital workforce or leverage the existing capabilities of other internal functions and/or third parties?

Tax professional skill sets – Emerging/evolving technologies are requiring Tax professionals to not only be proficient in tax rules and regulations, but also skilled in technology applications and the management of internal projects to implement such technologies and related processes. Do Tax professionals have the needed skill sets?

Finance is leveraging SSCs or CoEs for activities affecting Tax; however, these models are being quickly disrupted by RPA, accelerating the digital workforce.

Transparency requirements – Tax authorities are using the latest technologies to support their demands for increased taxpayer transparency. For instance, some tax authorities now require electronic submission of trial balances, invoices, and receipts. Can Tax keep up with these complex requirements with its existing technology landscape?

CFO focus on reduced cost – Tax needs to manage increasing complexity in an environment where there are competing priorities and tightening budgets. Can Tax effectively deliver the business case for additional investments in technology, people, and process or would leveraging external resources be a catalyst for these critical enablers?

Based on the 2017 PwC 20th CEO survey results, 93% of tech CEOs say that technology will significantly or completely reshape competition in their industry in the next five years. Finance and Tax are likely to experience the impact of these changes.

Tip

The correct model must be in place for organisations to enhance data. The reality is that Tax must first determine how to automate the extraction of data. Technology can facilitate the automation of data extraction and related processes. A focus on risk management, planning, and value creation is essential.

Tax technology – Key trends affecting Tax sourcing decisions

Tax functions are re-evaluating their sourcing models. Is the Tax function fit for growth?

Finance is leveraging SSCs or CoEs for activities affecting tax:

- *Routine, repetitive activities (SSCs)*
- *High value or complex functions (CoEs)*

AI and ML technologies are emerging:

- *Robotics is creating a new digital labor force for global Tax functions*
- *Ability to streamline and automate tax-related activities*

Finance is moving to the cloud for enterprise systems, providing a significant opportunity for Tax:

- *Evolve tax data management*
- *Leverage Finance processes*

Tax functions need the capability to respond to tax authorities' transparency requirements:

- *Base Erosion and Profit Shifting (BEPS) requirements such as Country by Country Reporting (CbCR)*
- *Tax authorities are requiring real-time extraction, automated fillings & e:invoicing; real-time audits*

Tax transformation has focussed on solutions to access source systems and enhance data and analysis:

- *Extract, Transform, Load (ETL)*
- *Self-service Business Intelligence (BI)/Visualisation*
- *Anchor to scalable technology strategy*

Varying automation techniques in each functional area:

- *Tax compliance and reporting*
- *Tax planning & transfer pricing*
- *International tax compliance*
- *International statutory financials*

Organisational pressure to reduce cost:

- *CFOs are elevating pressure to reduce fixed, recurring cost*
- *Tax must prioritise funding for automation of lower-value activities to create efficiencies*

What are available sourcing options?

Approaches to executing tax activities range on a spectrum from completely in-house Tax to use of a third-party service provider for comprehensive delivery of services pertaining to the complete tax life cycle. An organisation may deploy one or more of these options depending on the requirements of each Tax functional area. The graphic below highlights key features and benefits associated with each model:

	Internal			External	External with in-house experience
	In-house Tax function	***In-house SSC or CoE***	***Co-sourcing arrangements***	***Out-sourcing arrangements***	***Managed Services***
Key features	Substantially all tax activities performed internally by Tax or dedicated Finance personnel Requires significant investments in skilled talent and technology	Leverage Finance/other function shared centers for repeatable compliance and reporting activities Deploy focussed Tax centres of excellence for complex tax functions such as transfer pricing	Collaborate with external resources on certain activities within the tax lifecycle Leverage outside expertise on specific tax technical areas	Fully leverage service providers in fulfilling certain activities within the tax lifecycle Outsource strategic components of the Tax function	Comprehensively delivers Tax needs across the full tax lifecycle, including planning, financial reporting, compliance, and controversy Services delivered by highly experienced, integrated, former in-house team, leveraging a suite of leading technology solutions
	Ability to leverage technology				
Key benefits	Ability to leverage technologies in other areas of the business Opportunity to build internal knowledge and expertise in technology, project management, and other non-tax areas Legacy knowledge of the business and existing relationships with other internal functions	Minimise in-house Tax department to critical or highly sensitive areas Centralise and streamline performance of routine (SSC) or high- value (CoE) activities Leverage existing technology platforms to reduce spend	Retain in-house tax expertise to manage co-sourcing and other high-value internal tax activities and projects Access to external technology and expertise in certain functional areas Opportunity to implement technology or leverage existing platforms and networks for in-house functions	Allow internal resources to perform higher value activities such as strategic planning Reduce significant risks associated with global tax compliance Access to external technology and expertise	Access to fully scalable in-house team to meet specific needs Realise cost savings by consolidating tax expenditures to one dedicated service provider Integrated services for the entire tax lifecycle

A closer look

Let's consider each operating model further:

In-house Tax – Realistic in today's environment?

It is becoming increasingly difficult for Tax organisations to manage all aspects of the function internally. With growing complexity and pressures to reduce spend, Tax must be strategic in evaluating its core competencies and ability to deliver in certain areas. Where deficiencies exist, such as gaps in leading technologies or professionals with the appropriate skills, Tax may need to leverage non-Tax internal resources or engage third party service providers.

Shared Service Centres /Centres of Excellence – Declining in relevance?

Finance transformation has resulted in SSCs or CoEs for the purpose of centralising and streamlining activities that had been performed by separate business units of larger, decentralised organisations. SSCs have typically been used for processing high volume activities/transactions such as accounts payable, credit, collections, and payroll. Could Tax benefit from shifting certain activities to an SSC so that time is available to pursue other value-added activities? Tax organisations may leverage the infrastructure of an SSC for repeatable, indirect and direct compliance and reporting related activities; however, as technologies evolve, will the value of SSCs be eclipsed by a digital labor force with the advent of RPA utilities? With the emergence of AI and ML solutions, Tax may opt to automate structured activities, creating its own efficiencies internally.

> *"If a Tax function is doing things today that can be optimised by technology or a different model, consider those options."*
>
> *— PwC Tax Professional (former member of Tax leadership at Berkshire Hathaway)*

CoEs for Tax may remain a viable option for more complex activities that require specialised technology applications and subject matter expertise. Transfer pricing is an example of an area that may leverage a CoE or 'knowledge centre' focussed on specific analytics and requirements. However, CoEs for Tax may be available only to the largest organisations with the appropriate scale.

Co-Sourcing/ Outsourcing – Flexible option to accommodate change?

In some cases, engaging external service providers may be the best option for Tax. Co-sourcing involves shared responsibility with a service provider in the execution of a tax activity. For instance, a third party may prepare tax compliance while review and filing are retained by the in-house Tax function. Outsourcing involves a third party comprehensively executing tasks, such as the preparation and filing of indirect tax returns.

Engaging third parties in co-sourcing or outsourcing arrangements is the most familiar external approach for Tax and is likely to become even more popular with Tax functions in the future. These arrangements allow the function access to technology, expertise and resources where needed while maintaining control and ability to manage risk. Co-sourcing and outsourcing allows Tax to 'smooth' operations during peak seasons, technology transformation initiatives, and corporate transactions, ensuring that requirements are met with high quality.

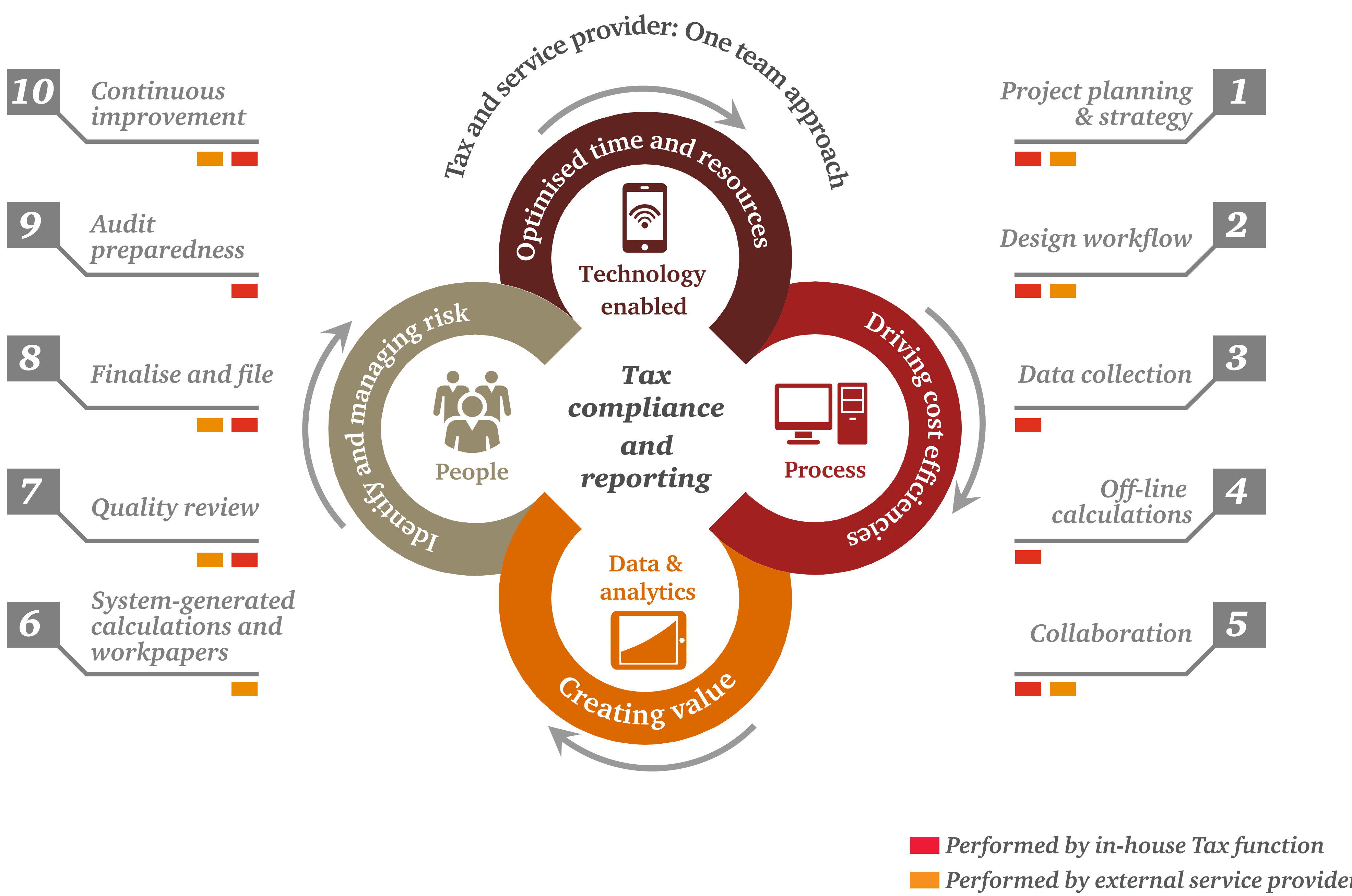
Access to talent, resources, and the agility of co-sourcing/outsourcing models serve as a catalyst for change, creating a mainstream alternative for Tax functions.

Tip

In some cases, tax may not be an organisation's core competency, which makes outsourcing or managed services attractive operating model options.

A closer look

There are various approaches to defining roles and responsibilities in a co-sourcing engagement with third-party service providers. The graphic below illustrates an example of co-souring for tax compliance and reporting.



A closer look

Managed Services – A holistic virtual solution

Managed services is a new Tax Function of the Future approach to using one service provider for substantially all tax needs. The hallmark of this approach is the use of state of the art technologies that are integrated throughout the tax life cycle, connecting planning with financial statement reporting, compliance, and finally with controversy. Service providers are experts in the technologies deployed as well as the full range of technical tax matters.

The managed services approach is emerging as an option for organisations undergoing corporate transactions (acquisitions or divestitures) or with complex tax requirements that can be enhanced and streamlined with an integrated technology approach.

Most companies have turned to a buy versus build approach, leading to more co-sourcing and managed services.

Case Study: Managed Services – A comprehensive tax sourcing approach

Overview

- The first of its kind, delivering on nearly all aspects of Company's tax operations across the globe.
- Represents a fundamental change in how the Company views its tax functions, including people, process, data and technology.
- As the Company's business continued to change, the variable cost and resource model created better flexibility, aligning the virtual Tax function to business objectives.

Background

- Recent changes in Company's portfolio created excess capacity within the Tax department.
- Company's desire to continue to receive best in class tax services at a significantly reduced cost with existing talents.
- Company's desire for its Tax professionals to concentrate on strategic activities such as tax planning and risk management.

Benefits

- Potential cost savings
- Ability to continuously right size the Tax function based on evolving needs
- Significant time shift to high value activities within the tax function
- Achieve a Tax function of the future model in delivering comprehensive tax needs
- Access to experienced in-house talent utilising leading tax technologies

Execution

- Contracted to provide an extensive range of managed global tax services on a network-wide basis over an initial five-year period.
- Lateral hire of a large number of tax professionals (500+ people across 40+ countries) and tax technologies (100+ applications) .
- Establishment of a dedicated team of managed services providers.

What are the challenges?

Regardless of the approach selected, certain challenges can impede the successful deployment of the Tax operating model. Consider the following key hurdles to avoid:

- ***Lack of defined processes and documentation***
  Before transitioning work to Finance centres or third-party service providers, it is critical that Tax understands its processes and ensures that they are clearly documented, reflecting all inputs and outputs expected for the process in transition.

  In some cases, 'quick wins' such as advance automation or streamlining of certain activities could help facilitate transition to a centre or third-party service provider.

- ***Insufficient collaboration with Finance and other impacted internal functions***
  Since Finance owns the financial data that Tax needs, it is imperative that Finance and any other sources of tax data (such as Legal and Treasury), be included early in the planning phase to facilitate smooth transition of all needed data and information.

- ***Poor co-ordination with third-party service providers***
  It is important to determine Tax's needs early to allow time for proper planning and co-ordination with third parties. In the case of Finance/Tax transformation or corporate transactions that require temporary or ongoing external services, third parties need to be involved in early discussions to understand requirements and prepare for a smooth transition.

- ***Change management***
  All internal and external stakeholders need to be apprised of the change in Tax operating approach and the benefits it affords the Tax function and broader organisation. Conveying these early messages may help prevent confusion and resistance to change.

"Organisations are challenged to successfully execute shared service centres because the need for clear hand-offs and ownership are essential but can be difficult to accomplish in Tax."

— PwC Tax Professional

"Finance cannot be avoided in executing Tax transformation. You have to build a process that solves both reporting and wider tax/ tax authority requirements."

— PwC Tax Professional

Tip

Change management is key. A better leveraged tax operating model would address proper review channels and well defined roles.

Wrapping up

How to get started?

There are many considerations in selecting the appropriate operating model for Tax to achieve its goals. One of the most important is the first step in the process – an assessment of the function's performance and ability to adapt to change. Is Tax meeting its objectives that are measured by established KPIs? And, does Tax have the capability, in light of regulatory and legislative changes, and increasing global complexity, to close performance gaps related to technology, people, process, and data?

The final step may be equally significant – effective planning and coordination. Without close attention to the execution of the transition, the new approach may fail to deliver an improvement in Tax's performance. Below are key factors to consider in evaluating a new Tax operating model.

- Self –assess: Consider performance against KPIs (tax cost, efficiency/ effectiveness, reputational and financial risk)
- Participate in workshop discussions with internal and external service providers to evaluate options
- Consider budget requirements of each model (technology, data, process, third-party fees (if applicable))
- Review most feasible model options with internal stakeholders
- Further explore requirements for the most desired approach
- Develop a plan and timeline for tax operating model transition

> *"Tax tends to follow Finance's lead in transformation efforts. It takes a strong Tax leader to initiate a transformation or shift in operating model without another instigator. Today, technology starts the conversation."*
>
> *— PwC Tax professional*

Connect with us

To have a deeper conversation about how these issues and predictions may affect you and your business, please contact:

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