

TAX COMPLIANCE TRANSFORMATION: RISKS AND STRATEGIES FOR GLOBAL MANAGEMENT



Foreword

The global tax landscape balances local, market-specific complexities with global initiatives aimed at simplifying and unifying the tax rules. Presently, this landscape is experiencing rapid change, as a result of efforts to both mitigate the effects of the pandemic, and to move towards parity in taxation between countries. The net result is more challenges for businesses and tax experts, who need to incorporate and account for these trends in their daily operations.

Considering the complexities within global tax landscape, there is more pressure on tax functions to implement the right level of controls, to provide overall transparency and to properly manage cross-border tax risks. As tax laws and accounting regulations evolve, tax functions are being challenged to re-evaluate the way in which data is collected, analysed and reviewed, and also to ensure that proper governance is in place, with the right level of approvals and the right risk mitigation plans.

This paper discusses not only the choices available to companies to manage these tax compliance challenges, but also examines how the tax transformation process could evolve over time.

We acknowledge that there is no such thing as a 'one size fits all' solution, given that different levels of transformation may be required according to an organisation's level of maturity. The evolution of a tax function's operating model is influenced by a business's overall strategy, its digital strategy, and also the organisation's appetite for risk. Where the appetite for risk is low, and the overall digital strategy focuses on the core business rather than support functions, outsourcing could be a good option to consider.

Tax transformation is not an easy task but it should be forward looking, accommodating existing and future trends, as well as any anticipated legal or regulatory changes.

Tax Compliance Transformation: Risks and Strategies for Global Management



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Introduction

Organizations are making various efforts to thrive in a post-pandemic world: shoring up their finances, accelerating digital and sustainable transformation, incorporating new ways of working, and identifying new growth opportunities. As businesses gradually stabilize, tax functions are playing a greater role and actively contributing to how organizations evaluate and determine their future paths. Broader organizational changes such as supply chain restructuring, corporate transactions (M&As, divestments, carve-outs, joint ventures), and digital business model rollouts, all have tax consequences. Therefore, it is vital for organizations to align their tax planning and tax strategies with business strategies.

Additionally, the global tax landscape is changing rapidly as economies navigate the pandemic. Governments and regulatory bodies are implementing tax reforms to assist local businesses and national or local economies and create opportunities for healthy cross-border relationships. While some changes may be one-time/temporary, others have longer-term impact. These changes have significant implications for the tax function, as they need to comply with new tax legislations and proactively anticipate future changes and challenges.

In light of this challenging and constantly evolving environment, organizations need to develop a robust strategy for tax compliance management, as tax is no longer a transactional back-office function and can have significant business impact on both the bottom line and the top line. They need to effectively manage tax compliance with focus on transforming the process in line with their business goals.

This research answers the following key questions:

- What are the key challenges in tax compliance management?
- What are the key enablers of transformation in the tax compliance process?
- Is outsourcing a potential solution for effective tax compliance management?
- What is the future outlook for tax compliance?

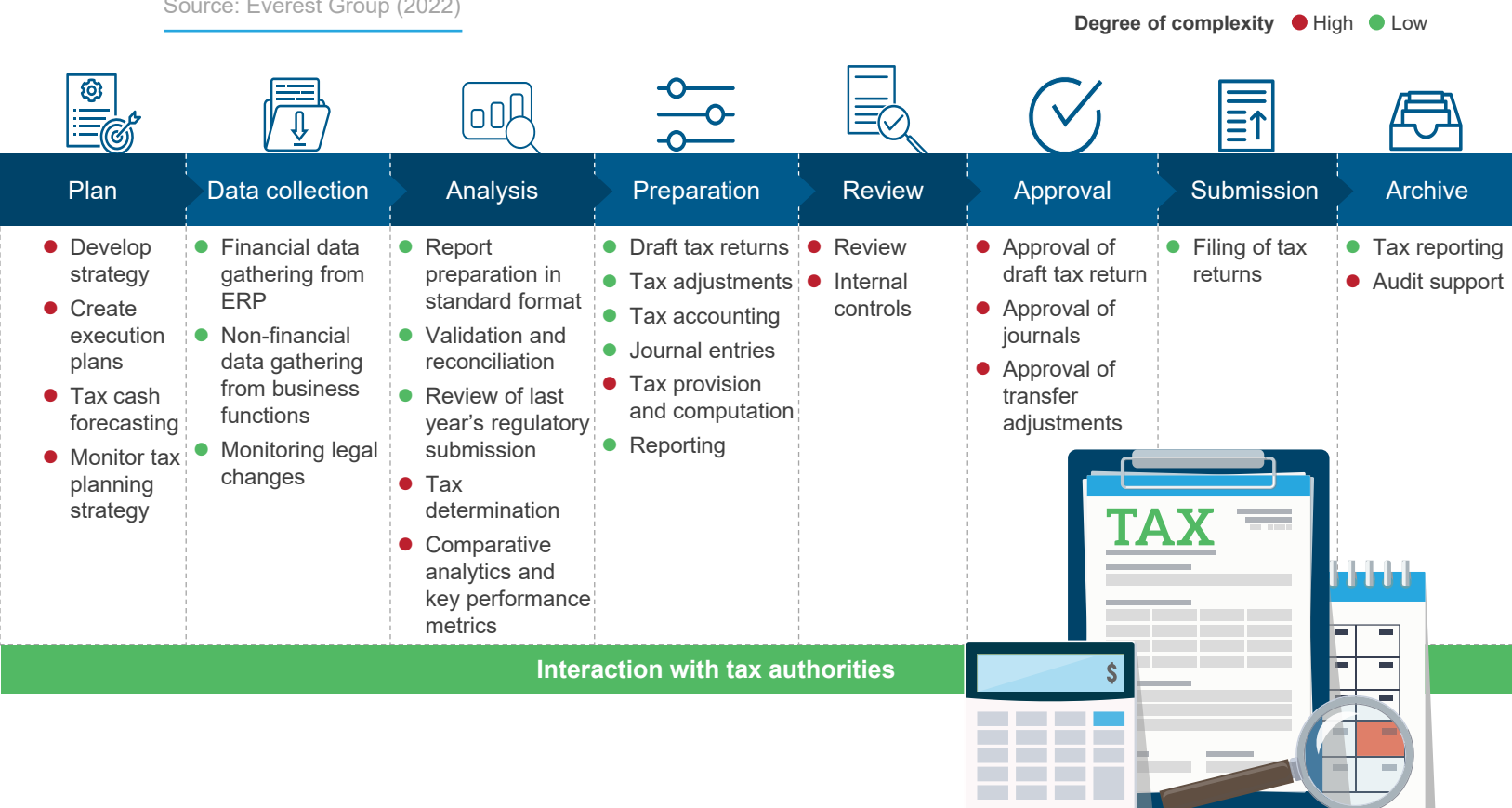
Key challenges in tax compliance management

Tax compliance management often starts with tax planning, including processes such as data collection, analysis, and, preparation, and ends with submission and archiving. Some of the underlying sub-processes are complex, while others are transactional. The following exhibit provides a view of the degree of complexity across the tax compliance value chain.

EXHIBIT 1

Tax compliance value chain – by degree of complexity

Source: Everest Group (2022)



Non-compliance on tax requirements can have severe consequences for a company, including financial penalties, suspension/termination of business, damages to brand image and reputation, and even imprisonment of the individuals involved. However, many global organizations fail to be fully compliant. The tax function often struggles to stay on top of information and changes at local and global levels, while managing the demand for more transparency. Tax professionals face many traditional challenges in addition to new complexities in the post-pandemic world. We look at these challenges below.

Traditional challenges in tax compliance

Some of the long-standing challenges in tax compliance include:

- Need to continuously monitor the evolving external environment and associated tax implications, including legislative changes, government policy, public opinion, and economic conditions

- Legacy IT and business systems impacting the tax function's agility to adapt to changes:
 - Organizations use legacy IT systems with a siloed approach to tax accounting and compliance and often with duplication of work and inconsistency in approach
 - Businesses over-rely on spreadsheets that are inconsistent and poorly managed and thus require an additional manual review
- Data consolidation and accurate and compliant reconciliation of information: The consolidation of information across geographies and business functions, such as legal, administrative, accounting, and finance, remains a top challenge for organizations in the tax compliance process
- Regional/Local complexities: These include managing local tax reporting, collecting necessary information to complete the filings, coordinating with statutory auditors, escalating issues when appropriate, and, in many cases, signing statutory filings and tax returns

Emerging challenges in tax compliance

Newer challenges in the tax compliance space include:

- Increasing tax complexities:
 - Introduction of a global minimum tax rate is impacting countries in which corporate income tax was not a concern until now
 - The Organization for Economic Co-operation and Development (OECD) has published draft rules for determining nexus and revenue sourcing and also updated its transfer pricing guidelines
- Evolving regulatory requirements:
 - Global and national regulations are changing as tax authorities seek to minimize leakages while attracting cross-border business
 - For instance, Poland has recently announced the introduction of e-invoicing in 2023. Romania is testing SAF-T reporting on large taxpayers and plans to expand it widely in 2023
- Stringent cross-border transaction reporting:
 - With rising complexities in tax processes, such as direct tax computation, transfer pricing, and tax adjustments, especially for global organizations, tax authorities demand detailed reporting of transactions/computations to minimize the risk of tax evasion
 - For example, the US has a complex and stringent set of cross-border reporting requirements under the Foreign Account Tax Compliance Act (FATCA). Non-compliance can result in reputational and financial consequences, as well as increased levels of tax withholding liabilities, interest charges, information reporting requirements, and penalties
- Changing tax enforcements:
 - Companies are facing increasing pressure to establish the right tax determination upfront, as errors can be costly, not just financially, but also in terms of the effort required to correct them
 - With tax authorities driving changes in the tax enforcement structure, organizations must enable real-time reporting and manage and monitor real-time tax data for payments
- Few industry benchmarks:
 - Benchmarking against comparable peers on taxes paid can be a powerful tool to ensure that the current tax management approach is in line with the industry

- The pandemic disrupted this benchmarking practice due to stimulus packages that impacted taxes in an unprecedented way
- Need to ensure data protection and security: To enable remote and hybrid working models, organizations must make relevant changes to tax compliance processes and underlying IT/digital infrastructure to ensure that they meet relevant data protection and security requirements

To navigate both traditional and emerging tax compliance challenges and leverage the tax function as a strategic partner for other business functions, organizations need to embrace an end-to-end transformation approach to tax compliance.

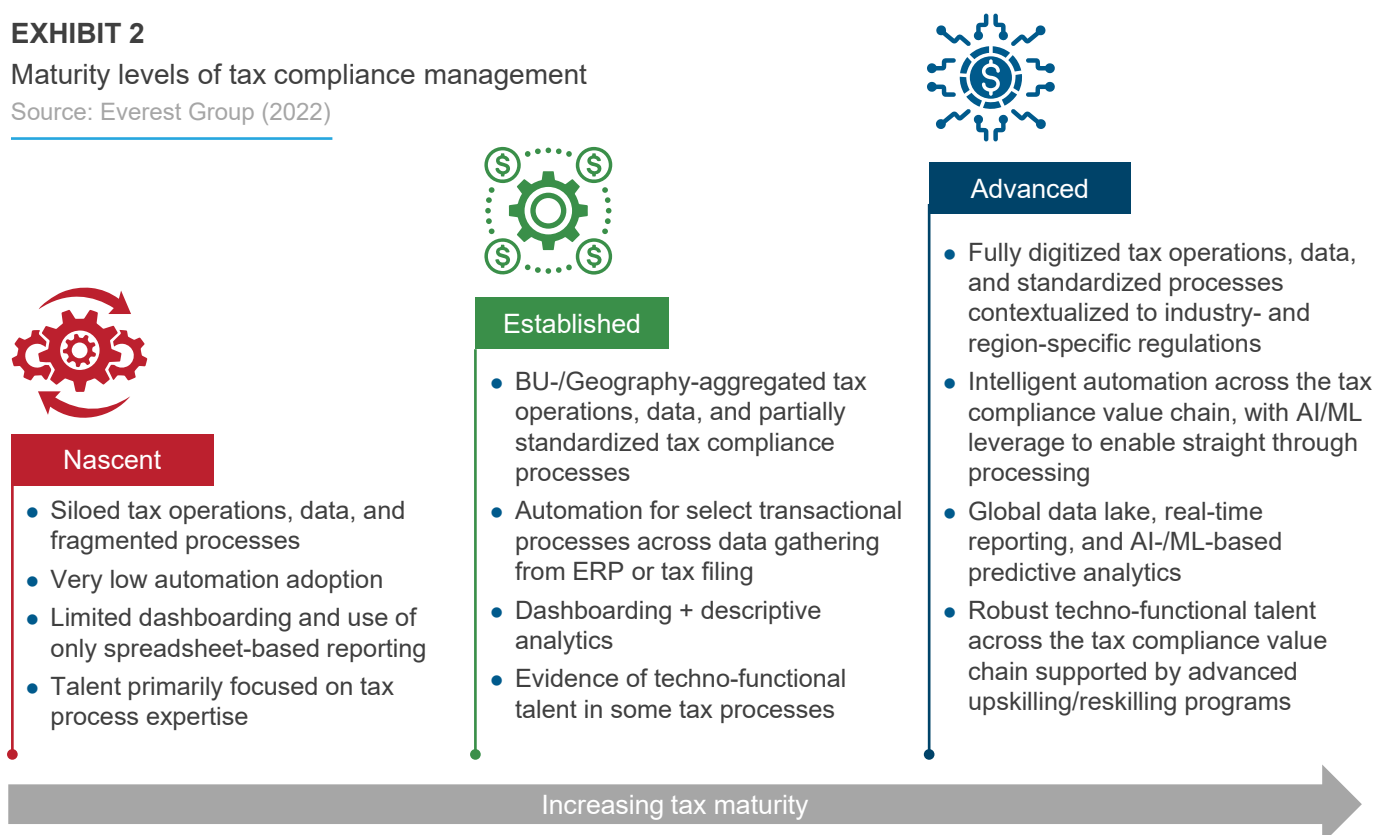
Transforming the tax compliance process

Typically, tax compliance management lags in maturity compared with other F&A functions such as accounts payable, accounts receivable, and general accounting. Based on the maturity of automation, process standardization, data integration, and technology leveraged in tax operations, companies can be placed in one of the three maturity levels as described in the exhibit below. The maturity of most existing tax operation organizations falls in the nascent stage.

EXHIBIT 2

Maturity levels of tax compliance management

Source: Everest Group (2022)



As organizations transition to higher maturity levels in search of improved cost savings, productivity, process efficiency, resiliency, and agility, they need to develop a holistic transformation approach that includes optimizing tax compliance processes, implementing digital levers such as automation and

analytics, and adopting the right operating models. Below we explore key levers that can help businesses in their journey toward creating a future-ready tax compliance process.

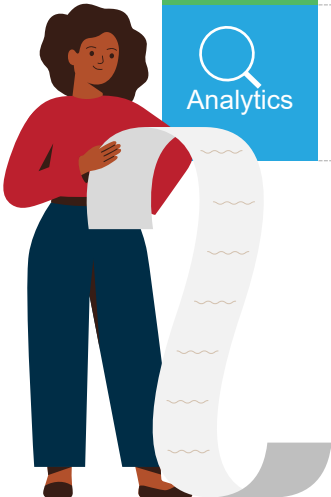
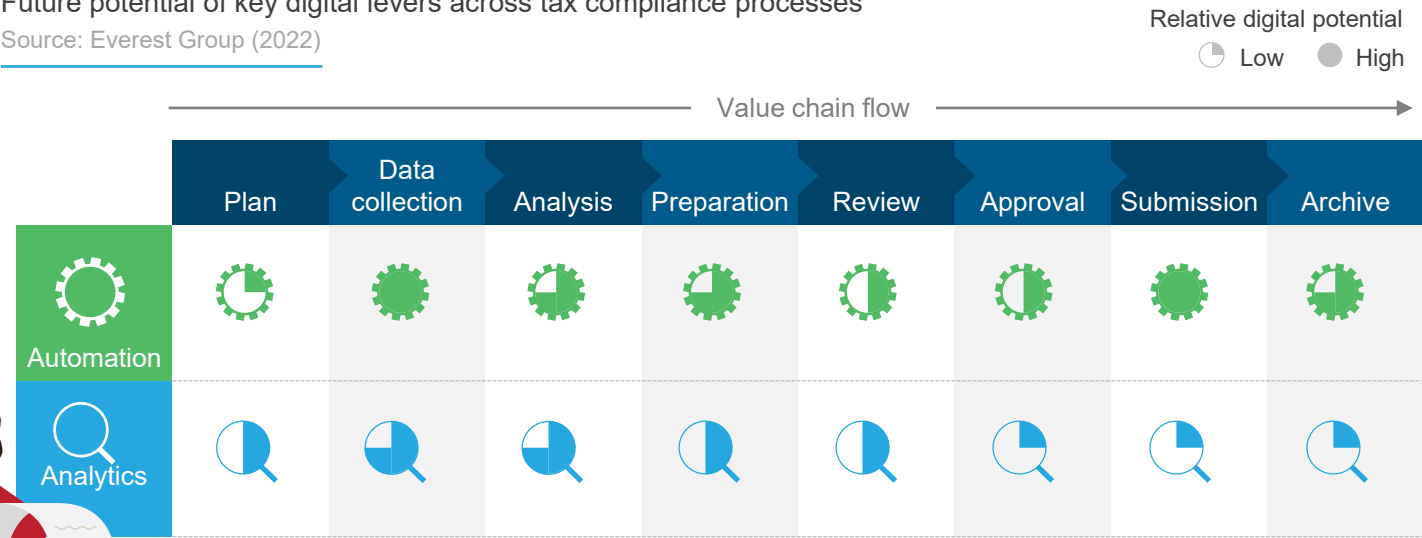
Process improvement: Process improvement is key to driving successful transformation initiatives at scale. Companies need to look at the state of their tax compliance processes and compare them with best-in-class processes to find ways to standardize them across direct and indirect tax categories. With constantly evolving tax compliance requirements, processes also need to be agile enough to adapt to future changes. Best-in-class practices include leveraging process mining and maturity assessment tools to identify bottlenecks and obtaining support from tax advisors and third-party service providers to reimagine and harmonize their tax processes.

For instance, companies are reimaging their processes in a way that data flows directly from the general ledger to the tax software (or tax computations directly embedded within the broader ERP platform) and leveraging integrated tools to reduce manual tasks and errors. The standardization of tax compliance processes across various business entities also helps in the agile implementation of any changes in tax laws.

Digital enablement: Analytics platforms and automation, with support from cognitive technologies, are key technology levers that drive tax compliance transformation. However, digital intervention potential varies across the tax compliance value chain. Processes such as data collection and submission have higher automation potential, while processes such as analysis and review have higher analytics adoption potential.

The exhibit below depicts how future digital intervention potential varies across the tax compliance value chain.

EXHIBIT 3
Future potential of key digital levers across tax compliance processes
Source: Everest Group (2022)



- **Automation:** Increasing automation builds more agile and resilient tax operations by reducing dependencies on manual interventions. RPA, in conjunction with Intelligent Document Processing (IDP) technologies, which capture and interpret data from multiple existing ERPs and other software applications for transaction processing, data manipulation, and communication, can enable end-to-end automation across the tax compliance value chain. Organizations largely leverage RPA in transactional tax compliance processes, such as rules-based data collection and validation, generation of standardized tax reports, and preparation of journals. Notably, many mature organizations are leveraging Intelligent Process Automation (IPA) to efficiently manage judgment-intensive tasks such as policy-driven reports generation and automated validations and control. IPA empowers tax professionals to be more effective by allowing them to focus on value-adding tasks that require human judgment and cannot be fully automated.
- **Data and analytics:** Most companies already use basic analytics and visualization tools for dashboarding and reporting purposes. However, with increasing pressure on tax functions to deliver business impact, the maturity of analytics solutions is increasing. Mature organizations are gradually moving away from manual manipulation and reconciliation of data to more descriptive dashboards that enable better decision-making. Data and analytics efforts are shifting to leveraging intelligent real-time analytics dashboards for processes such as transfer adjustment analysis and reporting, verification of sales and purchase declarations, withholding of tax declarations, and deriving of insights from changing tax regulations.

Orchestration of digital/process levers

Most tax transformation initiatives focus either on process improvement in silos or on digital enablement of inefficient processes. While the infusion of technology levers in silos may bring benefits in the short term, true success in the long term can only be achieved by carefully orchestrating different technology and process levers in conjunction with the expertise of tax professionals, as highlighted in Exhibit 4. Organizations' abilities to leverage digital and drive transformation will differ and depend on factors such as complexity of transactions, processes, and the organization structure.

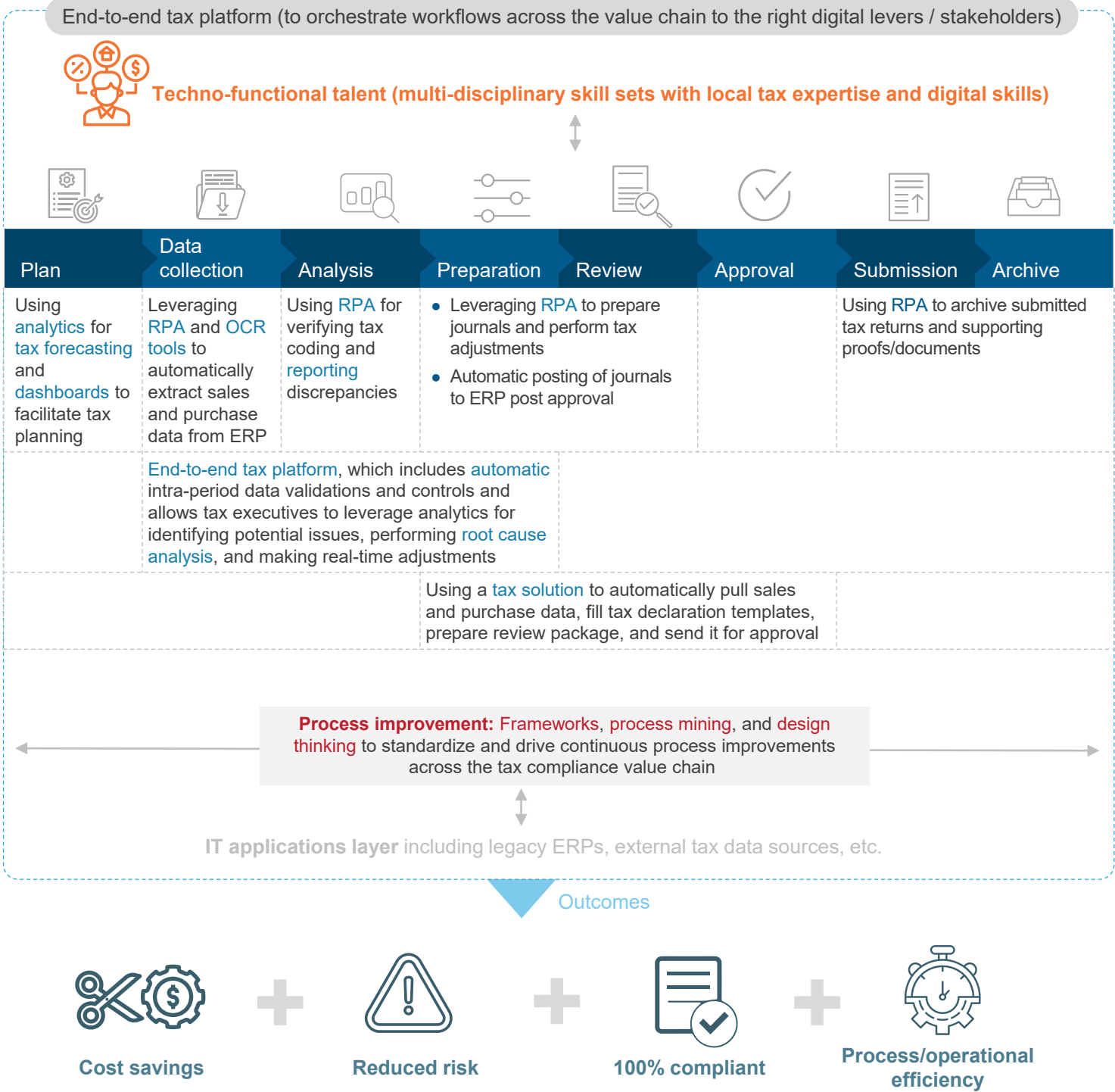
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EXHIBIT 4

Orchestrating digital and process levers to achieve tax compliance transformation – an example

Source: Everest Group (2022)

XX Process levers XX Digital levers



An effective tax transformation approach needs to be holistic and should focus on process standardization/optimization and digital enablement across the tax compliance value chain, along with the underlying IT infrastructure and applications layers. At the same time, the demand for point solutions, such as tax return, tax computation, workflow, and MDM solutions, is also growing. These solutions incorporate digital levers to address specific demands within the tax compliance process.

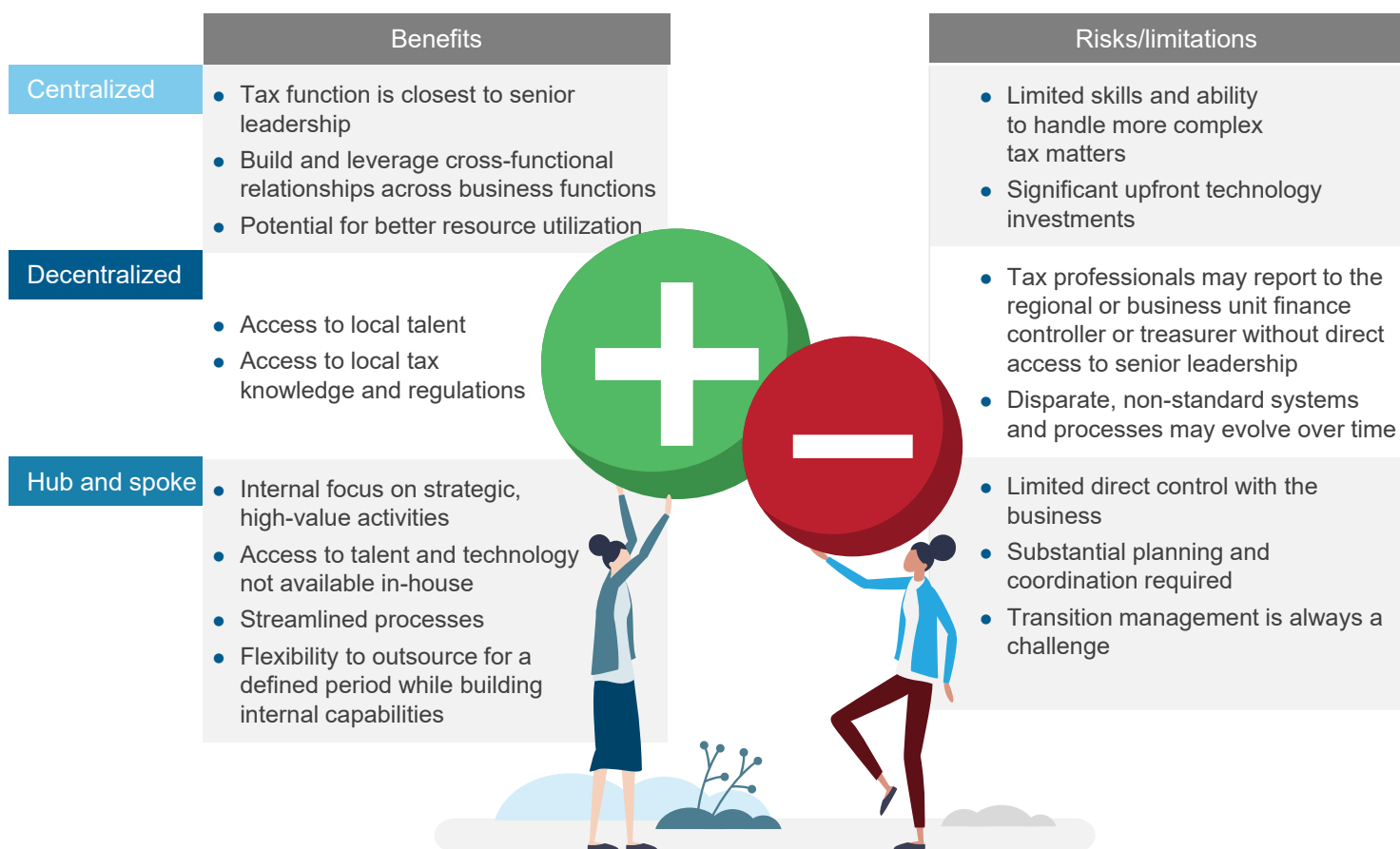
Evolution of the tax services operating model

As organizations expand across regions, they could choose from among different operating models to suit their unique requirements and objectives. The exhibit below depicts the different models and the benefits and risks associated with each.

EXHIBIT 5

Benefits and limitations of different operating models in tax compliance management

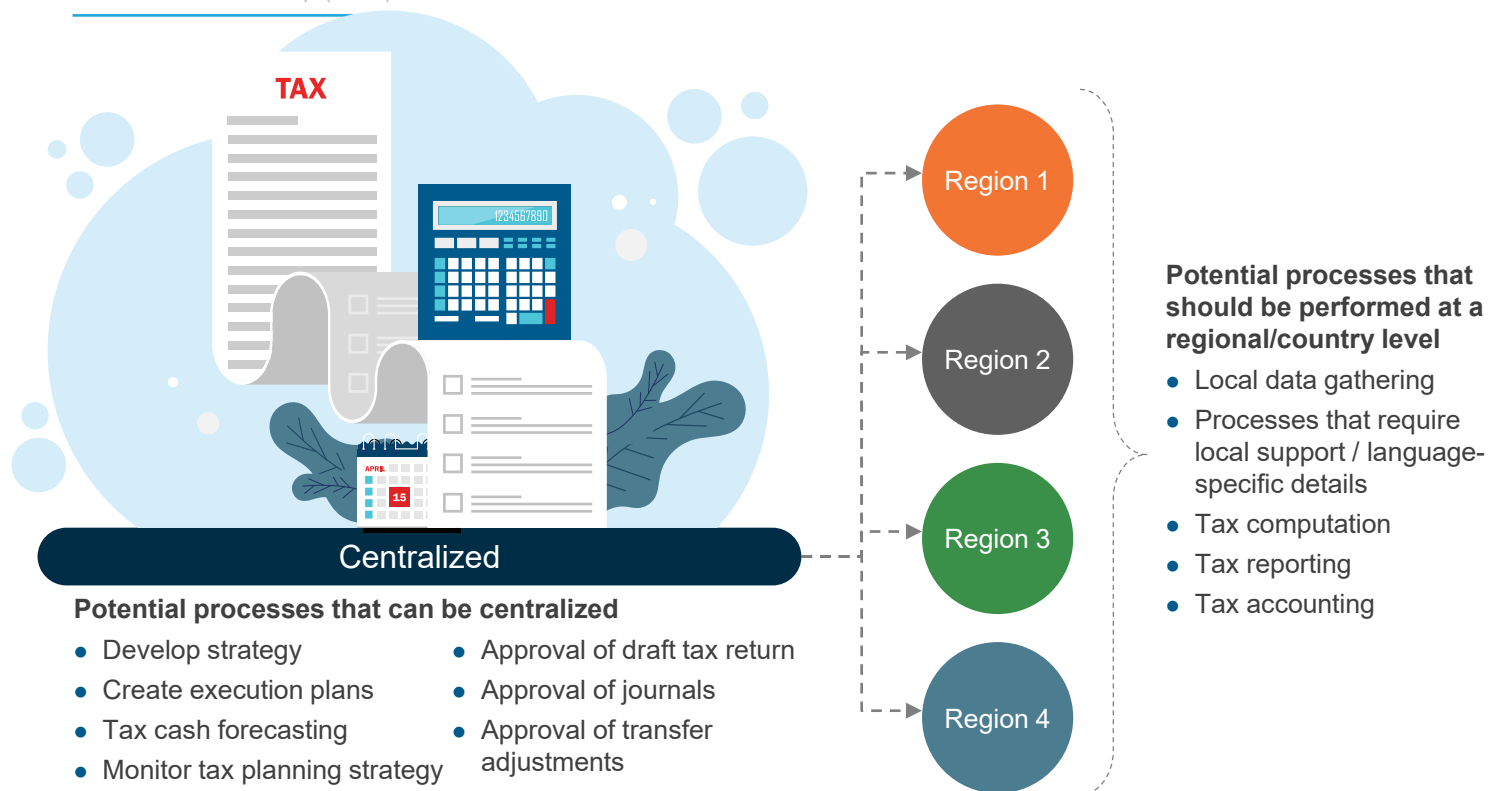
Source: Everest Group (2022)



While organizations must consider the different trade-offs with each of these models, best-in-class organizations prefer the hub-and-spoke model. Exhibit 6 illustrates how a hub-and-spoke model would look like in action and the processes that could potentially be centralized versus decentralized within it.

EXHIBIT 6**Centralized vs. decentralized processes in a hub-and-spoke model**

Source: Everest Group (2022)

**Key considerations when embarking on a transformation journey**

While the advantages of tax compliance transformation are immense, some factors may limit the benefits that companies can realistically achieve from a transformation exercise. To successfully transform tax compliance, companies need to:

- **Establish the right expectations:** Most transformation initiatives fail because of unrealistic expectations of quick wins at the start of the journey. Businesses must establish regular check points with stakeholders to ensure a clear understanding of expectations and value to be derived at each stage
- **Drive change management:** Driving major transformation efforts is not a one-off event; rather, it requires constant injections of new ideas and multiple iterations to determine an optimal approach. Change management is an ongoing process, and, in today's environment, ensuring an agile and flexible culture that responds rapidly to changing business/environment needs is paramount
- **Manage implications on tax professionals' evolving skill sets:** The tax compliance process, especially cross-border compliance, involves significant human intervention and a high degree of domain-/process-related skill sets. As tax compliance matures with digital intervention, organizations should upskill/reskill tax professionals with dedicated training so that they can work effectively with technology

Furthermore, companies should strike the right balance between scalability and accounting for industry- and region-specific nuances across the tax compliance value chain to ensure successful tax compliance transformation.

Outsourcing as a potential solution for effective tax compliance management

Third-party service providers are playing a crucial role in assisting companies throughout their tax compliance transformation journeys. While the maturity of outsourcing in transactional processes such as accounts payable and general accounting is much higher compared to the tax compliance process, buyers have become more willing to outsource tax compliance. Exhibit 7 shows how the tax compliance process is increasingly being outsourced in new F&A contracts nearly 2x more than other F&A processes and how providers are significantly increasing their FTEs to serve this increased demand.

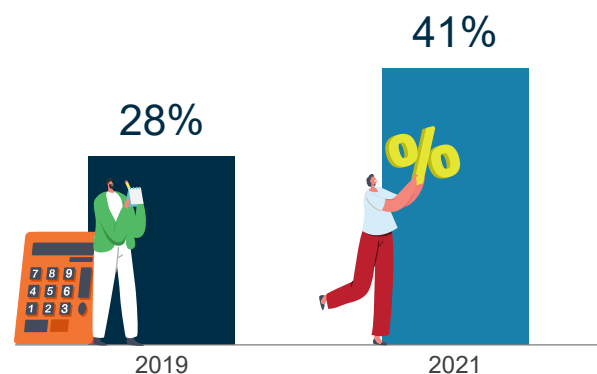
EXHIBIT 7

Increased outsourcing of the tax compliance process

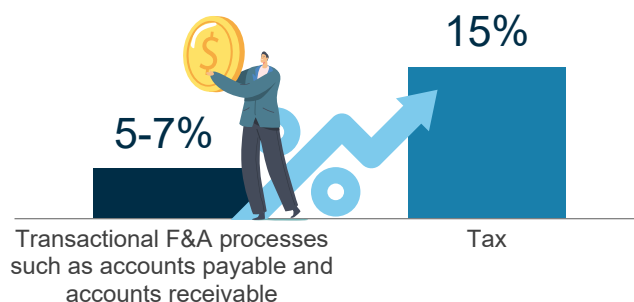
Source: Everest Group (2022)

Inclusion of tax compliance processes in new Finance and Accounting Outsourcing (FAO) contracts

Percentage inclusion in new contracts, 2019-21



Third-party service provider FTE growth across F&A processes vs. tax CAGR 2019-21



While the overall FAO market is growing at an 8-10% CAGR, the outsourcing of tax processes is growing much faster. This growth is substantiated by the massive increase in providers' tax FTEs compared to transactional F&A processes such as accounts payable and accounts receivable

Key areas where providers have developed capabilities and are actively assisting enterprises are:

- Maturity assessment and transformation roadmap design:** Providers have developed robust frameworks and methodologies to assess various aspects of tax compliance, such as data sources, process flows, and governance structures, to identify the maturity of the tax function. Leveraging a wide range of data/IP, providers help enterprises identify potential gaps and best practices to design a transformation roadmap contextualized to their specific organizations while factoring in the current underlying technology landscape, organization-specific nuances/challenges, and investment appetite
- Orchestrating transformation implementation:** In the recent past, third-party providers have invested in building robust digital capabilities, including tax-focused solutions such as accounting,

provisioning, and compliance tools, and broader digital solutions, such as workflow solutions, reporting and analytics tools, project management and collaboration tools, through both organic and inorganic routes. Third-party providers are increasingly playing the role of orchestrators in tax function transformation

- **Country-specific talent at global scale:** As organizations expand their global footprints, it is vital for them to have local tax expertise. Providers are rapidly scaling up talent with local expertise and can offer relevant skill sets at speed

While outsourcing the end-to-end tax compliance function may offer higher returns to some companies (depending on factors including scale and maturity), others can think about outsourcing part of their processes and/or leveraging a third-party as an enabler to their in-house tax compliance function. Companies can prioritize processes to outsource using the framework exhibited below.

EXHIBIT 8

A framework showcasing the outsourcing potential of tax compliance processes

Source: Everest Group (2022)

Business criticality	Low	 Can consider <ul style="list-style-type: none"> • Tax provision and computation • Tax determination • Journal entries 	Outsource  <ul style="list-style-type: none"> • Report preparation in standard format • Regional data gathering • Tax reporting • Monitoring legal changes • Review of last year's regulatory submissions • Financial data gathering from ERP • Audit support
	High	<ul style="list-style-type: none"> • Develop tax policy, planning, and strategy • Tax cash forecasting • Comparative analytics and key performance metrics • Monitor tax planning strategy • Approval of draft tax return • Approval of journals  Retain in-house	<ul style="list-style-type: none"> • Draft tax returns • Interaction with tax authorities • Validation and reconciliation • Review and internal controls • Tax adjustments and accounting • Filing of tax returns Can consider 
		High	Low
		Complexity	

Despite the benefits of third-party providers, organizations should remain cognizant of certain pitfalls to maximize the benefits from their relationships. The most common barriers to outsourcing any finance process are concerns about having limited control and oversight on day-to-day operations and increased risks associated with sharing confidential financial information with a third-party provider. Organizations should carefully evaluate providers' local-/country-specific expertise, ability to handle local complexities, and understanding of cultural nuances.

Future outlook for tax compliance

The future state of tax compliance will have efficient operations, real-time reporting of information to authorities, and streamlined data collection in a tax-ready format. The key themes that will define tax compliance of the future are:

The emergence of innovation Centers of Excellence (CoEs): As the tax compliance process matures, we expect businesses to set up dedicated innovation CoEs for tax operations that will not only focus on training/reskilling tax professionals, but also act as innovation centers for aspects such as standardizing reporting, setting best practices, and ensuring data protection to enable efficient tax compliance.

Evolution of the third-party ecosystem: While third-party providers such as tax advisors, BPO providers, and technology vendors currently work in silos to manage cross-border tax compliance, they will be expected to collaborate in the future to not only enable seamless data transfer and efficient operations of the entire tax compliance process, but also cross-leverage expertise and synergies to foster innovation.

Expected regulatory changes / upcoming tax complexities: Tax-governing authorities are expected to enact new regulations and standards to reduce tax evasion risks and improve efficiencies. Regulatory measures are expected to accelerate with the taxation of the digital economy and increased environmental tax burdens. With increased technology interventions, tax authorities are also expected to define standards in areas such as real-time reporting and real-time audits. These standards, in turn, will drive organizations to reassess their tax strategies and update processes to meet compliance.

Evolution of tax professionals' skill sets: Tax teams increasingly require technology-enabled skills to navigate the future. Notably, data gathering will become increasingly redundant and deriving relevant insights to help in critical decision-making will gain prevalence in the future. Tax professionals will also require appropriate interpersonal skills and critical thinking to effectively partner with other business functions and liaise between different authorities. A successful tax professional of the future will not only be an expert of the domain but also be proficient in deriving insights from data, performing statistical analysis, using technology platforms, and demonstrating change management and critical thinking skills.

Conclusion

The global tax landscape is changing rapidly, with severe implications for tax functions. Emerging global challenges, the evolution of digital technologies, and the need for tax functions to play a more strategic role in delivering business outcomes have put tax functions under the spotlight, making transformation a necessity.

As organizations think of transforming their tax compliance functions, they should carefully consider orchestrating different digital and process levers, with technology-enabled skill sets and professional tax expertise to maximize the benefits. Transformation strategies should incorporate elements such as stakeholder buy-in, change management, and evolving tax professional skill sets. Organizations can also consider leveraging third-party providers to gain a competitive advantage across their transformation journeys, as they bring robust technology, process, and specialized skill sets, coupled with deep experience and expertise. The stakes are high for the tax function; however, the evolving third-party ecosystem can play a crucial role in developing a future-ready cross-border tax compliance organization.

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