

Leading practices for
structuring a tax department
Questions and answers



Facing budget constraints and a shortage of skilled talent, many finance and tax leaders grapple with the best way to structure their tax departments and organize resources. Executives must respond to mandates for efficiency and cost reduction, while at the same time preserving the function's ability to perform effective tax planning, maintain quality reporting, and deliver value to the organization.

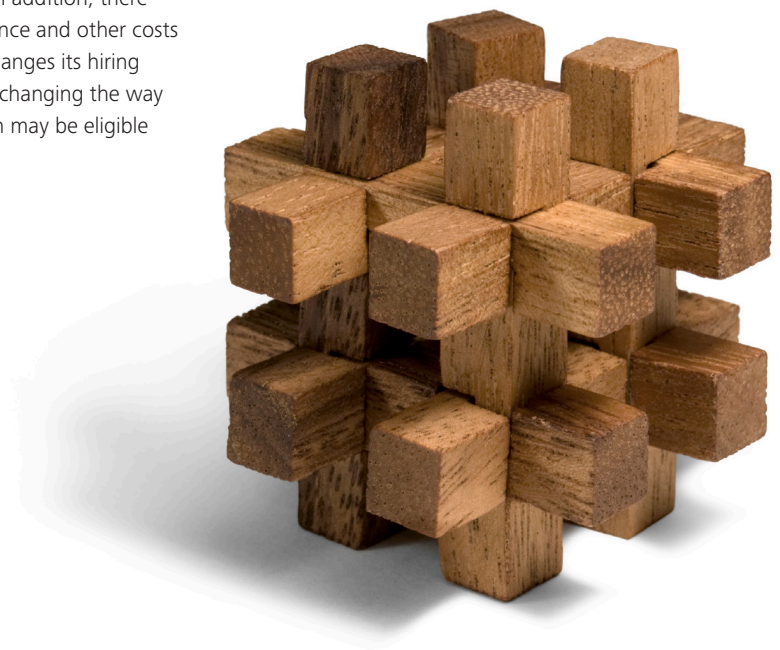
This article reviews some principles and leading practices for evaluating and strengthening tax leadership, structure, resources, and quality of reporting.

What are some of the current trends affecting tax organizations?

To deliver value today, the tax department should remain close to the business — that is, tax professionals should be in a position to recognize and then act on opportunities as the organization's business strategies or conditions evolve. An obvious scenario is participating in the structuring of a corporate transaction, but there are many other day-to-day events that may benefit from the tax department's upfront involvement in planning — if tax is aware of them. For example, in the wake of a downsizing, a company may need to close a plant. If the company received credits for building the plant, they may no longer be valid. In addition, there may be tax issues associated with severance and other costs related to a downsizing. If a company changes its hiring plans — hiring in a new state or area or changing the way people do their work — the organization may be eligible

for new work opportunity credits or employment training credits. Or if a company is building a new plant, there may be potential credits that can be negotiated with state and local governments. Similarly, if the company has plans to develop a new "green" facility, the tax department can help the company take advantage of any available credits among an evolving array of tax incentives in this area.

There are two key factors that affect a tax department's ability to stay close to the business. The first is the ability of specific tax decision-makers to be close to corporate or business unit decision makers. This can be challenging, given that many companies operate in many locations, which can include different countries. Business unit decision makers can be spread throughout an organization — corporate headquarters, larger operating unit, overseas, in a critical location, etc. — making it difficult for tax department decision makers to be in the same place. In short, tax departments today are being asked to organize themselves according to the broader business organization. To do this successfully and keep close ties to the business, tax leaders need to consider carefully the roles and skills of their professionals as well as their locations.



The second factor is the degree of access the tax department has to data sources and the people who are responsible for that data. This is dependent on the data and information-sharing capabilities of the technologies that are used within the organization.

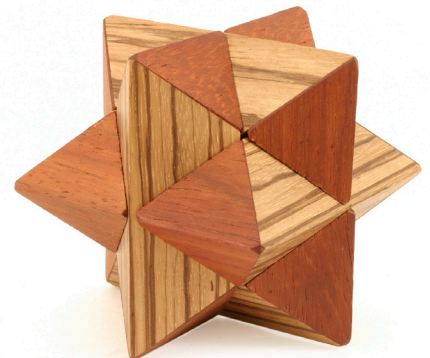
While tax departments can help their companies manage economic stress, they also are being asked to work harder and smarter. Efforts to increase efficiencies, such as the use of shared services centers, offshoring of some tasks, or cosourcing can help the tax department run more efficiently, but they may require new considerations for training or communication. Costs of these efforts can vary. The costs of establishing and maintaining a shared services center include extensive process change, documentation, and technology as well as people. Shared services centers also require continued use of highly skilled internal reviewers. Cosourcing arrangements typically include these costs and the transition work needed to create and maintain the infrastructure. In addition, as executives evaluate these alternatives, they should use care that tax operations stay close to the business.

How should tax departments organize resources to operate efficiently as well as afford sufficient time and focus to tax compliance, quality of reporting, and planning?

Most companies organize tax department resources according to functional area — federal, international, state and local tax issues, the tax provision (accounting for income taxes), compliance, etc. — with little sharing of resources. Some combine resources under a common manager — for example, it is not unusual for direct and indirect tax functions to report to one state and local manager — but they may retain separate staffing due to the differing nature and/or schedule of the work. More recently, some companies have reorganized tax compliance and provision personnel as they search for an optimal allocation of resources for these areas. In many cases, though, the two functions still have separate teams.

When considering how best to organize tax department resources, executives should consider a variety factors, including company size, workload type, and industry. A clear definition of workload (type, volume, timing, and complexity) and the organization's existing technology, dataflow, and processes should help determine the number of tax professionals and skills needed. Factors such as industry and company size will influence the division of the tax labor pool across tax functions (international, federal, state, sales and use, etc.) and tax activities (planning, compliance, auditing, and provision). While efficiency in the tax organization is certainly an objective, it should not compromise the organization's ability to perform effective tax planning. Quality of short-term tax planning and reporting is now as important, if not more important, as long-term tax planning.

In a large, complex environment, it is more difficult for the tax function to see everything that is happening within the business and to react accordingly, especially when there are overseas operations. The larger the enterprise, the more appropriate it will be to organize tax resources by business unit and align those tax resources according to the business unit's area of focus. Organizing by business unit can foster a proper level of understanding of the company's operations and environment. How many tax professionals should be assigned to each business unit? That depends on the related tax issues and the quantity and complexity of data requirements. Most business units can be classified according to their tax issues and requirements, and tax professionals can be assigned using the 80/20 rule.



A functional structure facilitates development and application of specific tax knowledge and experience. But, given traditional peaks and valleys in certain tax groups, it can result in less-than-optimal efficiency. Instead, pooling resources across tax functions — that is, having fewer teams working in “silos” — can help leaders adjust resources more efficiently to fill specific needs. This approach may require more cross-training and more planning across all resources, but it is perhaps the fastest way to leverage resources effectively and provide adequate focus on planning. Technology applications also may improve efficiency by alleviating staff of time-consuming or manual processes, but these software applications often take longer to produce the benefits and return. However, the success of a pooled staff structure often hinges upon the manager’s own tax technical knowledge and his or her ability to manage the people as a team as well as ensure the tax function has the right tax processes and technology in place.

Another common question related to tax department structure is how to allocate responsibilities between the tax and accounting functions. Studies estimate that approximately 40 percent of tax compliance work is spent on gathering and assembling accounting information, so would it be better to transfer certain responsibilities to accounting in order to utilize tax resources more effectively or work with accounting to develop alternative solutions? In addition to focusing on allocation of responsibilities, most companies would be better served by taking steps to produce truly tax-sensitized data from the start. Doing so can reduce the time required to gather and assemble information — for both functions — and enable an organization to use its resources for more productive planning exercises.

What processes should leaders of tax functions have in place to enable effective day-to-day operations — regardless of structure?

To support both their tax compliance and planning responsibilities, tax departments should have in place effective communication, information-sharing and measurement processes across functional areas.

Information-sharing and communication are similar, but different concepts. Information-sharing helps team members have timely access to the data and information they need to perform their jobs. Constant and regular communication, on the other hand, provides team members the context they need to use the information and to perform their responsibilities according to expectations.

Communication and information-sharing are particularly important when teams are based in multiple locations, as is often the case today, or when they include individuals outside the department such as consultants who do not work on site day in and day out. There are many tools and technologies available that enable groups to work together in real time, without being in a common location. These include dashboards, electronic work papers, and portals.

Measurement is essential to breaking down silos and building a more cohesive team that is focused on common goals. If a tax department establishes common measures across groups, then the individual members of those groups are more likely to assist others and to work together to achieve the desired outcomes. It is important to use care in setting measures, however, as they do drive behavior — both good and bad.

There are debates about which type of leadership yields the greatest value from the tax function. What types of corporate oversight and functional leadership style typically work well?

Corporate oversight of the tax function tends to be size dependent; the larger the department, the more likely it will report to the enterprise's chief financial officer. Smaller tax groups more often report to the company's controller and, indeed, more organizations today are adopting this line of reporting. In the past several months, we have seen an increase in tax directors reporting to the controller. This appears to be driven by the current economic environment and an increased emphasis on income tax reporting. This may not be the right long-term strategy, however, for yielding value to the company.

Which is the right approach? The answer depends, of course, on the company and its financial leadership. The key, in any environment, is making sure that the tax function has good visibility of the business and a seat at the table in discussing developments within the business. In general, the decision as to whether the tax function reports to the CFO or the controller can be assessed by the focus of the department. If the tax department is focused on becoming more proactive in value-add tax planning activities, reporting to the CFO is likely to be most suitable. On the other hand, if the department is focused on improving quality and efficiency in tax reporting, then reporting to the controller might be the best choice. If the focus is in both areas, the CFO is likely to be a good fit.

Is it better to have someone with tax technical knowledge leading the function or a strong manager who has good technicians in specific functional positions? Technical knowledge and guidance can be critical to commanding presence with senior management and directors. Most organizations will find it advantageous to have a tax

technical specialist in the functional leadership role, with strong process and people managers running the function's day-to-day operations. Just as important, though, is the tax leader's communication style and capability — in particular, the ability to translate technical and complex tax topics into business terms that senior executives can understand and assimilate into their business strategies.

What are the advantages and disadvantages of shared services centers and offshoring arrangements?

Shared services centers can potentially improve efficiency and alleviate administrative burdens. In addition, personnel in shared services centers often are closer to certain data sources, which can be helpful when performing tax compliance or provision activities. On the other hand, shared services centers typically are further removed from the business and less likely to be aware of changes occurring in the business. To retain its ability to plan, an organization with heavy compliance activities might consider splitting activities — putting some in a shared services center for efficiency purposes and keeping others in a typical corporate structure that has proximity to the business.

Because shared services environments operate with a premise that resources are interchangeable, this type of arrangement may require more training — given the technical nature of tax activities. In addition, if the shared services center is not in the same physical location as related finance functions, tax leaders may need to heighten the focus on communication and relationship building to enhance staff access to the data and information they need.

Over the past five years, more and more organizations have explored the potential of offshoring certain administrative tax activities. While some have used offshoring successfully, these arrangements can be difficult to establish. Offshoring does carry risks; the lack of proximity to the business is magnified when tax practitioners work in another country, and additional training may be required to develop the requisite knowledge of, and experience in, U.S. tax law. Companies that utilize outsourcing/offshoring arrangements often do so with the expectation of being able to use resources interchangeably — that is, to handle multiple responsibilities. Companies need to use care when assigning responsibilities to outsourced or offshored teams that they have the required tax technical experience.

When is it beneficial to consider offshoring? One of the most important factors is the size of the tax department. In a large department with hundreds of people — including many in process-oriented roles — it may be feasible to take certain roles offshore for efficiency purposes, for example, if there 25 or so people who do a certain type of compliance work. Many tax departments, however, simply are not large enough to consider a robust offshore strategy. Offshoring is designed to capitalize on economies of scale, but it is difficult to achieve this when the function in question involves 10 people.

An option for companies with a smaller number of roles is to integrate these with larger offshore finance operations and have finance provide supervision for targeted tax roles. Usually, finance operations have the scale to make offshoring work, and tax can piggyback off of that effort. This arrangement will require added coordination, however, to ensure that it truly supports tax objectives.

Companies that have utilized offshoring successfully often start with indirect taxes — customs, value added taxes, and sales and use taxes — as these involve repeated processes, a relatively constant workload, and heavy reliance on data.

Which benchmarks can companies use to determine whether their tax departments are structured and operating effectively?

Tax departments use a variety of benchmarks to evaluate their structure and operations, for example:

- Cost of the department relative to revenue.
- Cost relative to the number of legal entities.
- Cost relative to returns filed.
- Percentage of time or resources devoted to planning versus compliance.
- Effective tax rate relative to a peer group, particularly common in some industries.

Each one of these has its advantages, but also its drawbacks. For example, a simple measure such as revenue may not make sense if a small company is very complex from a tax perspective and requires more or different resources than other companies of its size. Likewise, benchmarking based on number of returns filed may not be appropriate for a business that has extensive sales and use tax requirements and files thousands of such returns.

For most organizations, there is no single appropriate benchmark that is appropriate for determining tax function structure or size. Companies will need to use a variety of measures — depending on size, complexity, and global footprint — to assess the size and structure of their departments. More than anything, it is important to be aware of the limitations of specific benchmarks and to understand how they can affect comparisons and decisions.

About Tax Management Consulting

As the legal and regulatory environment continues to grow more complex and as businesses continue to expand globally, leading-edge tax departments will play increasingly important roles in risk management and the overall performance of the enterprise. Tax departments of the future need to be strategic, agile and, above all, focused on creating value for the business.

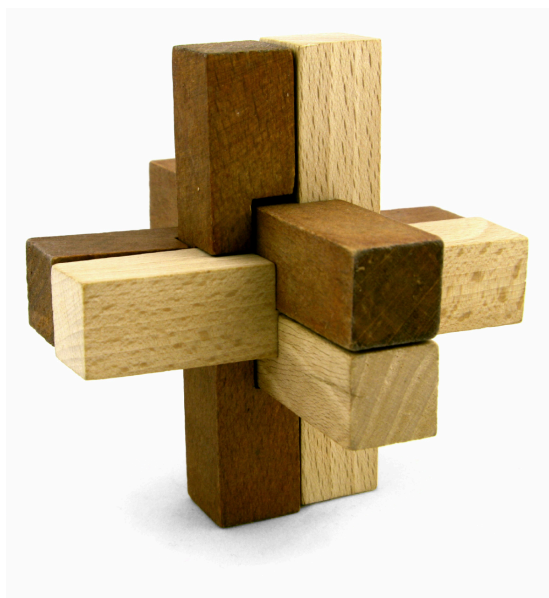
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