

Tax payments and
cash management
Delivering the goods



With the credit crunch continuing to proliferate throughout the world, more and more companies are feeling the effects. Decreasing cash flows and the inability to borrow funds have prompted many organizations to increase their focus on cash management. Increasingly, finance executives are asking the tax function to contribute to these efforts to preserve and generate cash.

Deloitte hosted a [Dbriefs](#) webcast to review a framework that can help tax functions adopt a cash-focused view of their key activities — with an emphasis on cash tax payments. Nearly 1,400 executives joined to learn more about the tax payment cycle, enablers for generating cash, timing difference considerations, and opportunities for developing a sustained cash-management focus throughout the function. Participants shared their own views through responses to polling questions.

A framework for organizing cash-management activities in a complex environment

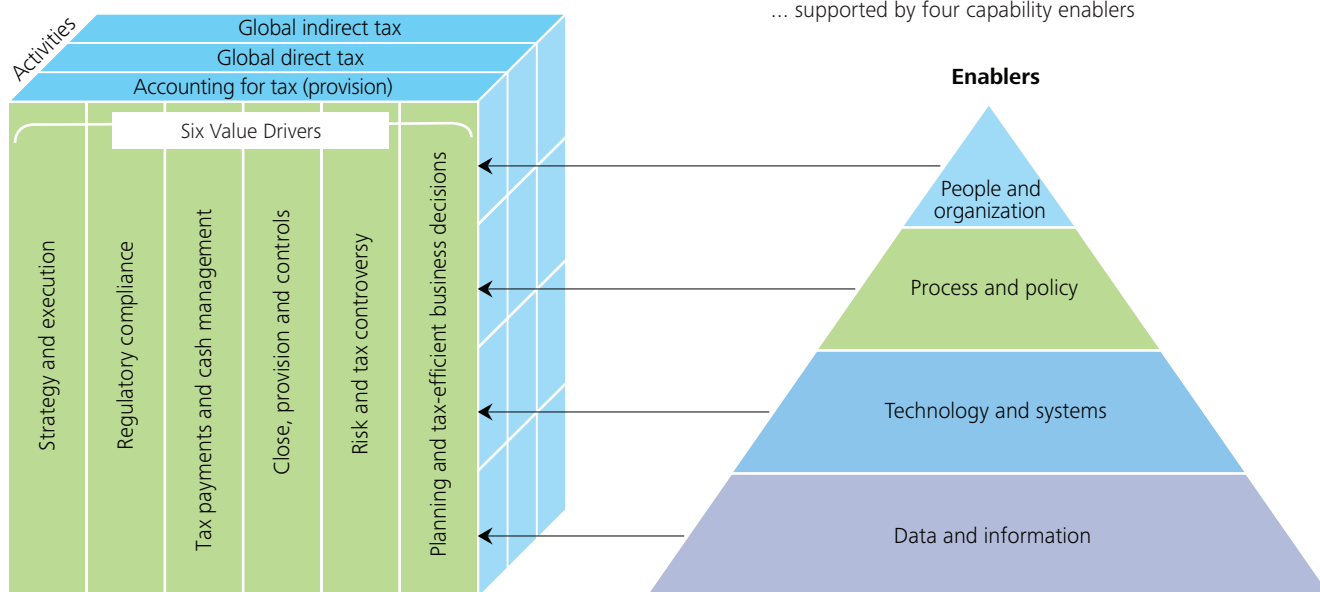
The tax function is uniquely positioned to generate significant cash-flow benefits in a short period of time. Tax laws provide companies with various methods to calculate their tax bills and to manage the timing of their payments;

however, the complexity surrounding corporate taxes sometimes prevents efficient planning. A framework can help organize and prioritize initiatives in a complex environment, putting a spotlight on the highest value areas — today, one of those being cash.

To help tax departments understand opportunities to deliver value to the enterprise, Deloitte utilizes a framework (see exhibit) that consists of three primary elements:

- The key **activities** that the tax function performs. These may include direct and indirect taxes, as well as accounting for income taxes.
- The areas in which tax departments can produce **value**. The framework below identifies six key value drivers. This article focuses primarily on one: the cash tax and payment process and its overall connection to treasury and cash-flow items.
- Tax **enablers** — the tools and resources that can help the function deliver value. There are four primary tax enablers, as depicted on the pyramid. At the foundation of this pyramid are data and information: the source of many of the issues tax departments encounter as they prepare baseline accounting data for tax work.

Assessment framework that incorporates the tax department's key processes and enablers



Although the tax function can offer value to its organization in many ways, now may be a prime time to focus resources on quick-hitting cash-management opportunities. Using the tax enablers as a guide, the table below outlines some of the leading practices that can help align tax payment processes with the enterprise’s cash-management goals.

Enablers	Characteristics	Measurements
Data and information	<ul style="list-style-type: none"> • Tax-aligned source data provides the foundation for accurate estimates and calculations of liabilities. • Tax and treasury work from the same source data sets to ensure alignment. 	Fully loaded cost of incorrect tax payments: <ul style="list-style-type: none"> • Capital cost of prepayment • Interest and penalties of underpayment
Technology and systems	<ul style="list-style-type: none"> • Tax technology tools are integrated and include cash projection capabilities. 	
Process and policy	<ul style="list-style-type: none"> • Payment processes align with enterprise cash-management strategies. 	
People and organization	<ul style="list-style-type: none"> • Adequate resources are applied to the function. • Responsible personnel are highly connected to treasury. 	

Cash generation from tax planning

Proactive planning is the key to staying in front of taxing authorities’ increasing demands.

Tax planning is a cash-generating event. But, over recent years, companies have focused more of their attention on permanent differences, primarily due to the effective tax rate benefits, and have given lower priority to temporary differences. Now, many organizations are revisiting these areas of focus as their organizations seek to generate cash.

Timing differences generate costs and benefits based on the time value of money. These costs and benefits vary directly with interest rates. In a low interest rate environment, one of the key considerations is the spread between the interest rate on overpayments and underpayments — particularly given the pressure from taxing authorities to provide more cash through exams and adjustments. Length of time can also influence the cost/benefit equation when the period for certain planning items is so long it creates “quasi-permanent” timing differences.

Given the cash challenges that many companies face today, now is the time to look at both timing differences and permanent differences. In the current environment, certain “big-ticket items” could produce cash flow and enable a tax department to contribute to company objectives. Potential areas of focus include:

- Fixed assets
- Reserves
- Repairs and maintenance
- Inventory
- Accrued expenses
- Estimated taxes
- Revenue recognition
- Section 199
- Energy credits
- Research and development credits
- State planning
- International planning

Two keys to effective planning are data and the ability to sustain planning. All of these items depend on good data. But, access to data that can produce fact patterns is one of the biggest roadblocks to planning for many organizations. Is it simply too difficult to obtain the data necessary to gain as much benefit as possible from these planning areas? Without the right data, many of these potential big-ticket items are less productive than they could be, and many organizations find it difficult to implement planning ideas permanently.

Timing differences:

An estimated tax payments example

One way to illustrate the impact of timing differences is to look at the mechanics involved with estimated tax payments. Timing differences can affect both the timing and amount of estimated tax payments. Estimated tax computations — done on a quarterly basis — should warrant more of an organization’s attention given the new rules in effect since 2008, although most companies have not updated their processes for calculating estimated taxes. Under these new rules, the ability to project taxable income is extremely important. Companies must factor tax planning into their quarterly calculations, but they also need to be wary of the potential for penalties for understating temporary or permanent items.

Estimated tax payment dates. The estimated tax system is and always has been a “pay-as-you-go” system. Corporations make payments quarterly, on a schedule that is fixed and applicable regardless of the method used to compute estimated taxes or of the annualization period used.

Quarterly estimated tax payment schedule

- 1st Quarter: 15th day of 4th month (April 15th)
- 2nd Quarter: 15th day of 6th month (June 15th)
- 3rd Quarter: 15th day of 9th month (September 15th)
- 4th Quarter: 15th day of 12th month (December 15th)

Annualization period alternatives. A company can choose to calculate estimated taxes based on standard monthly periods, or it may choose one of two optional annualization periods, as illustrated in the exhibit below. Many organizations may find it beneficial to revisit past annualization decisions in light of today’s tight cash environment.

Installment	Standard Monthly Periods	Optional Monthly Periods #1	Optional Monthly Periods #2
1	3	2	3
2	3	4	5
3	6	7	8
4	9	10	11

To use an optional annualization period, a company must file an annual election on Form 8842, *Election to Use Different Annualization Periods for Corporate Estimated Tax*, each year — even if it chooses the same option every year. A company may elect a different option each year, but once an option is chosen, it may not be changed within the year. Form 8842 must be filed by the 15th day of the fourth month, regardless of computation periods elected. In any case, it is important to remember that these are the periods for computing estimated taxes; the payment due dates remain standard.

How can a company tell which of these methods would yield more cash? One place to start is looking for the presence of some seasonality to the business that, if computed month to month, would produce material swings in the projected taxable income.

Amount of required estimated tax payment. In general, each installment must equal at least 25 percent of the lesser of:

- 100 percent of the tax shown on the current year’s return, or
- 100 percent of the tax shown on the prior year’s return (provided the prior year was not a short tax year).

Large corporations — defined as those with taxable income of at least \$1 million for any of the immediately preceding three taxable years — can only base their first quarter installment on 100 percent of the prior year’s tax. In an environment where cash is an issue and the company has diminishing taxable income year over year, eligible organizations should consider whether it is appropriate to base the first-quarter installment on the prior year’s tax. Alternately, they may compute each installment using an annualized income method or an adjusted seasonal method.

Rules for computing estimated tax payments. There is more than one way to compute estimated taxes. The general rule is to include income and deductions in the period specified by the taxpayer’s method of accounting. But, seven special rules may come into play if one of these factors exists:

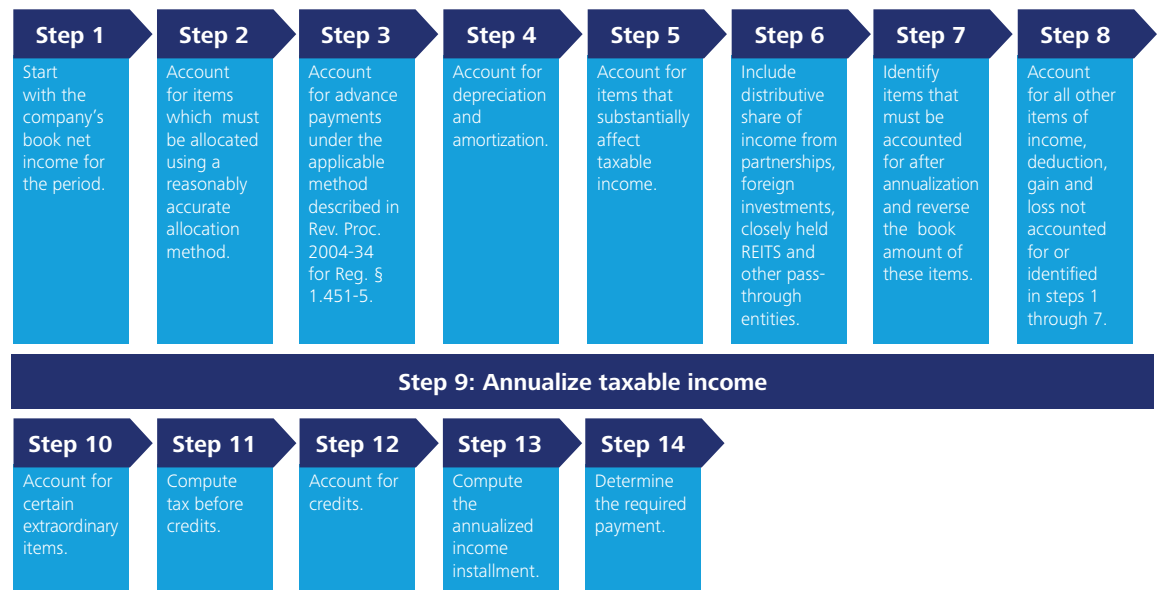
- Reasonably accurate allocations
- Advance payments
- Extraordinary items
- Credits
- Depreciation and amortization
- Certain items that substantially affect taxable income
- Distributive share of items

Companies should review facts each quarter to determine if one of these special rules applies. Each one of these situations involves different computations — and this requires having the processes and technology in place not only to capture items properly, but to consider tax planning items that may affect the timing and amount of the estimated tax payments.

Putting it all together. In today’s environment, three months can feel like an eternity. Since tax payments represent a substantial cash outlay for most organizations, giving additional care and attention to calculating estimated tax payments is one area where the tax function can support the organization’s goals in a tangible and significant way.

The exhibit below outlines a 14-step process that companies can use to work through the annualization process — with a focus on whether the process is producing the most advantageous result for the organization’s particular situation.

14-step process annualization process



Cash management: A transformational approach

Once tax has identified short-term cash value opportunities, it should look for ways to embed these cash-management activities into day-to-day processes and sustain their value over time. Doing so requires cross-functional efforts; therefore, a holistic approach is necessary to keep all players aligned with cash-management goals. One way of doing this is to focus on each set of tools that tax uses to do its work — the “enablers” presented earlier.

Tax department’s key processes and enablers

Data and information	<ul style="list-style-type: none"> • Document the data to both compute the book/tax differences and to understand the root cause of the opportunity. • Calculate the tax adjustment(s) and drive adjustment into the estimated payment process. • Identify the technology, processes, and organizations that can help fix the root cause. • Use these findings to establish the transformation plan.
Technology and systems	<ul style="list-style-type: none"> • Enterprise systems – recognize that tax creates no source data and work with system owners to tax sensitize the source data as early in the process as possible. • Data gathering – determine what tools your organization has or needs to capture the necessary information to refine the quarterly estimated payment process. • Calculation tools – use the capabilities in your current compliance systems to tune up your payments.
Procedures and policies	<ul style="list-style-type: none"> • Redesign both tax and non-tax processes to support refined calculations. • Determine that your company’s controls framework are a prominent part of the design. • Work with finance leadership to adapt policies and procedures to address the root causes.
People and organization	<ul style="list-style-type: none"> • Communicate with and train professionals across all functions of the value that can be created through the stronger cash management. • Establish metrics for success and regularly communicate results. • Change organizational roles and responsibilities to match critical needs.

Tax executives' views

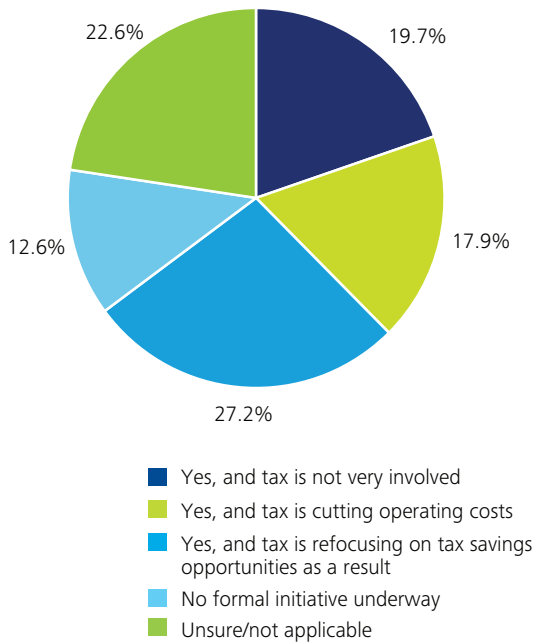
Deloitte hosted a [Dbriefs](#) webcast on May 21, 2009, to review a framework that can help tax functions adopt a cash-focused view of their key activities — with an emphasis on tax payments. Nearly 1,400 executives joined to learn about the tax payment cycle, enablers for generating cash, timing difference considerations, and opportunities for developing a sustained cash-management focus throughout the function. Participants shared their own views through responses to polling questions.

In the current environment, many organizations have put in place new measures to preserve and generate cash. Accordingly, many webcast participants reported that their organizations are executing some cost-cutting measures and that the tax function is involved by refocusing on

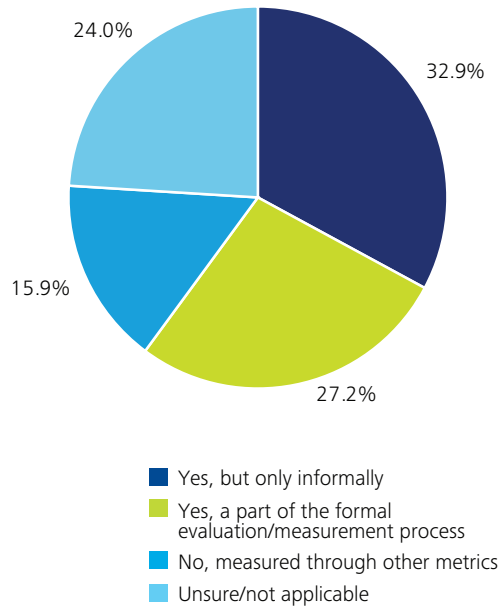
tax-saving opportunities (27 percent) or cutting operating costs (18 percent). Another 20 percent said that while their companies are executing formal cost-cutting and/or cash-liquidity initiatives, the tax function is not very involved in those activities. Surprisingly given the breadth of the economic downturn, 13 percent of respondents said their organizations currently do not have formal initiatives in place designed to reduce and/or manage costs.

More companies today are making cash taxes and cash tax management a part of their goals and objectives. Nearly 60 percent of respondents reported that cash taxes and cash tax management are a part of their companies' leadership goals and management — either formally (27 percent) or informally (33 percent). Only 16 percent said that their companies use other metrics.

Is your company currently executing a formal cost-cutting and/or cash liquidity initiative? And, how involved is tax in the initiative?



Are cash taxes and cash tax management a part of your company's leadership goals and objectives?

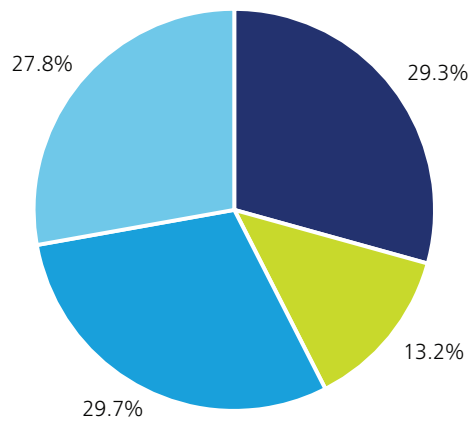


Source: Deloitte's Tax Operations Dbriefs webcast, "Tax Payments and Cash Management: Delivering the Goods" held on May 21, 2009. Polling results presented herein are solely the thoughts and opinions of survey participants and are not necessarily representative of the total population of companies.

Participants' tax organizations are mixed in their current efforts to discover cash-flow benefits. Surprisingly, 30 percent of respondents said that their tax functions have initiated no specific efforts to discover cash-flow benefits. Another 30 percent have done some analysis — looking at a few large timing differences to discover cash-flow opportunities. Only 13 percent said their organizations have analyzed substantially all timing differences — turning over every rock, in effect, to generate cash flow.

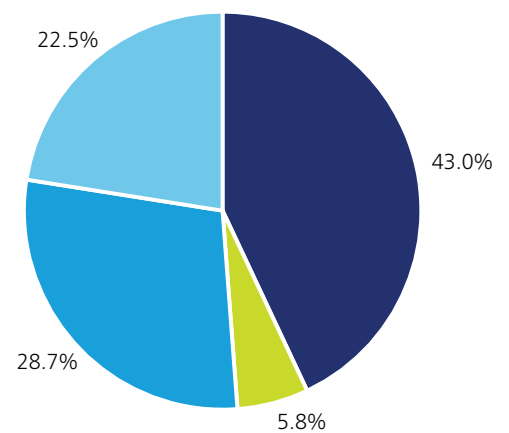
Most participants have identified sources of opportunity for enhancing company cash flow through tax payments. Forty-three percent indicated that their organizations' greatest opportunities to do so are through cash tax planning and savings, while another 29 percent indicated that their greatest opportunity to enhance cash flow lies in obtaining more accurate source data to calculate estimated payments. Only six percent said their greatest opportunity would come through adopting a different method for calculating estimated payments.

Within the last year, has your tax function initiated specific efforts to discover cash-flow benefits?



- Yes, we have analyzed a few of our large timing differences specifically to discover cash-flow opportunities
- Yes, we have analyzed substantially all of our timing differences specifically to discover cash-flow opportunities
- No, we have taken no formal action beyond our regular reviews
- Unsure/not applicable

What is the greatest area of opportunity to enhance company cash flow through tax payments?



- Cash tax planning/savings opportunities
- Adopting a different method for calculating estimated payments
- Getting more accurate source data to calculate estimated payments
- Unsure/not applicable

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Additional resources

For more resources that can help address the challenges tax departments face today, visit www.deloitte.com/us/movetaxforward.

