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TAX

Good, Better, Best

China

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Introduction

For the KPMG network, a top priority is helping member firm clients manage tax transformation and position their businesses for future success. Since 2006, we have conducted regular surveys of tax executives around the globe to uncover their most pressing issues. Our purpose is to gain insights on how these issues influence changes in structure, investments in people and processes, and overall objectives and priorities.

Now, in this updated survey conducted in late 2012, the environment in which tax directors operate has changed dramatically. Lingering economic uncertainty is increasing pressure on companies to cut costs and on tax authorities to boost revenue. Globalization continues to spur centralization of finance, tax and other functions. Companies are expected to improve their governance, accountability and transparency in all areas. Further, political attitudes toward taxation are shifting, with much more focus on civic responsibility and public demands that companies should pay their "fair share" of tax to the jurisdictions where they earn profits.

With this environment as a backdrop, we sought to identify trends and benchmarks on the following fundamental questions:

- How are tax departments changing their operations to address emerging economic, business and regulatory trends?
- How are they progressing on aspects of governance and performance such as strategy, risk management and measurement?
- How are they approaching process and technology investment and improvement, including the impact of cloud computing?
- How are they addressing the pressure to more effectively resource how they do their work?
- How are they responding to rising tax authority scrutiny and demands?

The survey now shows that tax departments have made good progress in several of these key areas. However, in a rapidly changing business and regulatory environment, the results also suggest that there is still work to do if tax departments are to meet the dual challenges of effectively managing risk while providing more effective, real-time support to business activity.

Focus on China

Based on KPMG International's survey of tax executives, tax departments of China-based multinational companies are:

- **ahead of their global counterparts in developing and documenting tax department and risk management strategies** that are aligned to overall business objectives
- **slightly below global peers in the level of board engagement** in the development of targets and metrics to measure tax department performance
- **expected to devote more time on financial reporting activities versus activities that could add value to the business,** suggesting that the tax department is perceived primarily as a service provider to the finance function
- **rapidly centralizing activities to direct and control the global tax function** but losing ground on the standardization of tax department processes and controls
- **reporting rising levels of aggressive tax audits and disputes,** requiring them to devote more time to compliance and leaving less time to provide proactive business support.

KPMG's series of benchmarking surveys of tax department structures and operations has shown that leading tax functions – those that add the most value to their businesses – do so by putting high priority on three areas:

1. ensuring clarity of accountabilities
2. driving standardization and efficiency
3. promoting connectivity with their colleagues across the business through a proactive, outward-reaching tax function.

In conducting the 2012 survey on behalf of KPMG's member firms, we were keen to see how tax functions have progressed in these areas, especially given ongoing economic uncertainty and continuing regulatory reform.

This report highlights insights from the survey on how China-based tax departments have advanced since our last survey in 2009. For analysis of the global survey results and additional country reports visit kpmg.com/goodbetterbest.

Clarity of accountabilities

Tax departments in China have markedly improved their tax governance in the past 3 years. In this current survey, nearly all China-based respondents (96 percent) say they have a tax strategy that is consistent with their overall business strategy – an increase from 76 percent in 2009. The percentage of respondents who say their board has approved the strategy also rose from 54 percent in 2009 to 72 percent in this current survey. A further 72 percent of respondents say their board or corporate leadership has guided the strategy's development.

The research shows that China-based tax departments are slightly ahead of their global peers in terms of having their strategy documented: 66 percent have formally documented the tax department strategy, compared to 63 percent globally. A further 78 percent have also documented their approach to tax risk management, compared to 71 percent globally.

96%
of China-based tax departments have a strategy that aligns with their overall business strategy

72%
of tax department strategies have board approval

Survey results show that companies based in China have less focus on key performance indicators (KPIs) than their global peers. In some areas, the differences are small. However, other key KPIs such as accurate and timely tax return compliance, managing tax risk, tax process improvement and technology utilization are 10 percentage points or more behind global peers.

Driving efficiency – standardization driven by finance functions

Since 2009, tax departments in China have made significant efforts to centralize their tax departments' operations: currently, 86 percent of respondents say they have a tax function that directs, manages and coordinates tax activity at the global level versus 48 percent in 2009.

This result is in line with the global trend (76 percent now report having a headquarters tax department, up from 56 percent in 2009). However, tax department centralization appears to be occurring more quickly and more frequently in China. This may reflect the growing importance to global companies of their Chinese operations.

Despite increased centralization, the levels of standardization reported by China-based respondents in the areas of tax controls, responsibilities and accountabilities of tax personnel, policies and procedures are below those reported globally. Levels of standardization for processes that comprise the annual tax compliance cycle (from forecasting through financial reporting, filing of returns and reconciliation) are also below those reported globally.

Since 2009, reported levels of standardization by China-based respondents have fallen in all categories. Survey results suggest this change may have resulted from changing priorities of finance functions. The percentage of China-based respondents who agreed that their company's finance leadership drives standardization of the global tax function to some extent has declined since 2009.

Further investment of tax department activities and processes does not appear to be a high priority. Only 44 percent of China-based respondents say they have an overall tax strategy and operational review planned or in progress, compared to 62 percent globally. Similarly, only 42 percent have process-related improvement projects in progress (61 percent globally) and only 32 percent are undertaking technology-related improvements (53 percent globally).

As with reported levels of standardization, these results have dropped sharply since 2009 and also suggest that tax departments in China are afforded less priority than the overall finance function: 84 percent of respondents in China say their company is undertaking a finance function strategic review 61 percent globally).

76%
of China-based tax departments have KPIs for accurate/timely financial reporting

66%
have KPIs for cash tax savings/tax deferral

60%
have KPIs for accurate/time tax return compliance

86%
have a centralized headquarters tax department, up from **48%** in 2009

12%
of respondents in China agreed that finance leadership drives standardization "relentlessly", down from **28%** in 2009

Compared to their global peers, China-based tax departments are also making less use of outsourcing and shared service centers to conduct tax compliance activities. Outsourcing is often used strategically to free up in-house resources for other activities and to access leading practices, specialized resources and investments that cannot be developed in-house.

Currently 22 percent of respondents from China say they use outsourcing to carry out or support tax department responsibilities, compared with 34 percent globally and 20 percent say they use finance or accounting shared service centers for this purpose.

Interestingly, the 22 percent of China-based companies that outsource tax department activities are making much more use of third-party providers than they did in 2009. For example, 82 percent of these companies say they outsource corporate income tax compliance work (44 percent in 2009), 64 percent outsource tax controversy support (22 percent in 2009), and 55 percent outsource corporate income tax provision work (22 percent in 2009).

These results indicate that some China-based companies are becoming more strategic in their outsourcing practices and more confident in accessing specialized tax resources from third parties when business needs arises.

44%
are engaged in or planning a tax strategy and operational review

84%
are undertaking finance function strategic reviews

Promoting connectivity — work to do in communicating value

Despite signs that China-based tax departments may be interacting more with boards and upper management, there seems to be little desire to improve connectivity with other parts of the business. Connectivity between the tax department and other departments is important to ensuring that tax teams are collaborating as proactive business partners in setting and advancing business objectives and contributing value to the company. Within China, however, it appears that the ability of tax departments to drive value is not recognized.

As noted, financial reporting activities are considered to be the most important of the tax department's activities in China. These activities are expected to take up 19 percent of tax department time in the next twelve months. Tax compliance activities are expected to occupy about 17 percent of the tax department's time, and management of tax authority audits is expected to occupy 12 percent of their time. In contrast, China-based respondents only expect to spend 9 percent of their time on integration with business groups and early indication of routine transactions.

In total, over one-quarter of tax department time is expected to be spent on tax compliance and managing tax audits, and it seems likely that these activities will demand even more time in the future. Tax directors in China need to devote significant time and effort in developing good working relationships with the Chinese tax authority.

30%
of respondents from China are involved in transfer pricing controversy, up from **16%** in 2009

30%
are involved in federal income tax controversy, up from **10%** in 2009

These efforts have been challenged in recent years, as China has introduced several income tax reforms and issued new circulars affecting many different types of transactions, including cross-border transactions. Reported levels of tax disputes have tripled since 2009 in the areas of corporate income tax and related to indirect tax. China's tax authority has stepped up its audit activity in the area of transfer pricing, and it has grown more aggressive in challenging international structures on the basis of beneficial ownership of income.

Even though tax compliance work and managing tax audits will consume ever more tax department time, leaving less time available for other, more value-adding pursuits, China-based respondents appear satisfied with the existing status quo: 92 percent are satisfied with their current administrative budgets, 70 percent are satisfied with levels of investment in tax technology and process improvement, and only 10 percent expect the structure of their tax department to change in the near future.

As global economic uncertainty continues, pressure on tax departments in China to reduce costs will continue to mount. As aggressive tax audit and controversy escalates, tax departments that continue to do business as usual could find themselves falling behind. Through additional standardization, process improvement and tax technology, China-based companies have opportunities to boost efficiency so they can keep up with their compliance. Doing so will free more of their time to focus on the more value-adding aspects of the tax department's role, especially in their ability to proactively collaborate with their colleagues across the business to provide them with effective, real-time support and drive value.

30%
are involved in indirect tax controversy, up from **8%** in 2009

92%
are satisfied with their current administrative budgets

Blueprint for change

As tax departments struggle to cope with mounting regulatory and cost pressures, leading organizations are seeing that a transformational approach can show the way forward. KPMG International's research has distilled the following steps as crucial elements in a tax department's blueprint for change.

1. Establish a **common purpose** by aligning strategic goals and objectives of the tax department with those of the wider company.
2. Define **one view of performance** to monitor effective tax management by clarifying requirements and how performance is measured and valued, through agreed-upon KPIs.
3. Ensure the tax department has **high-performing teams** with the right number of tax professionals and the right mix of training, skills and experience.
4. **Embed processes** to realize the tax management strategy in a way that is measurable and sustainable for the long-term.
5. Set systems and procedures to produce, exchange, and distribute **timely and accurate information** to the right people, at the right time, and in the right format.
6. Employ **enabling technologies** (e.g. enterprise resource planning systems, tax software) to automate labor-intensive processes that consume resources and increase risk.
7. **Influence stakeholders** by understanding their goals and constraints and communicating with them to help achieve the goals.
8. Set processes and priorities and align the tax department's structure to promote **connectivity and collaboration** between tax teams and other departments.

About the survey

- KPMG International's global survey of people in charge of tax policy and operations of businesses worldwide is one of the largest surveys of its kind.
- Iterations of the survey have been conducted regularly since 2006, charting the evolution of leading tax functions and identifying operational benchmarks for high-performing tax teams.
- For the 2012 survey, 1,150 heads of tax in 22 countries, including 50 respondents in China, took part in blind telephone surveys to share their opinions on how tax departments are adapting to current business challenges. About 700 respondent companies are Fortune 500, Forbes 2000 or equivalent companies.
- To gain more clarity on the telephone survey results, additional in-depth interviews were conducted with several clients of KPMG member firms and tax professionals worldwide.

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Designed by Evalueserve.

Publication name: Good, Better, Best – China

Publication number: 121477

Publication date: April 2013