KPMG

cutting through complexity

TAX

Good, Better, Best

Japan

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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 and influence on the bottom line.

Focus on Japan

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

- **making some progress in the tax governance and the adoption of global strategies for their tax departments** in line with that of the broader business but they still lag behind their global peers
- **less focused on tax planning and tax risk oversight,** presumably due to historical Japanese attitudes toward tax as a social contribution rather than a business cost
- **missing opportunities to derive more value from their tax departments** through activities such as:
  - benchmarking and performance measurement
  - centralization of activities into headquarters tax departments
  - automation and standardization of tax processes and controls
  - leveraging their sourcing models (e.g., by making strategic use of outsourcing, co-sourcing and shared service centers).
- **experiencing rising levels of tax audit activity and more tax disputes,** which can be expected to draw more resources to serve compliance needs at the expense of other, more value-adding activities
- **in a position to vastly improve their ability to provide effective, real-time support to business activity** by investing in technology, process improvements, and structural change and by improving their connectivity across the business.

KPMG's series of benchmarking surveys of tax department structures and operations has shown that leading tax departments – 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 department.

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

This report highlights insights from the survey on how Japanese tax departments have advanced since our last survey in 2009. For analysis of the global survey results, read *Good Better Best*, and visit kpmg.com/goodbetterbest for more country reports, industry-related data, interactive tools and more.

Clarity of accountabilities – board and tax interaction rises

Since 2009, global companies based in Japan have made some progress in the area of tax governance but they still lag behind their global peers: 66 percent of Japan-based companies now have a tax strategy that is consistent with their overall business strategy, up from 34 percent in 2009 but well below the current global average of 93 percent.

Survey results show that upper management and directors are taking more interest in and responsibility for tax matters within the company: 54 percent say their board or upper management was directly involved in guiding the development of the tax department's strategy, up from 26 percent in 2009, and 68 percent say their board has approved their tax department's strategy currently, up from 42 percent in 2009. Again, despite these gains, interaction between boards and tax departments appears to be lower than that reported in most other jurisdictions.

Japan-based companies also appear to be less focused on tax risk oversight. Only 58 percent of respondents report having a documented approach to risk management, well below the global result of 71 percent, and only 54 percent say that their board or corporate leadership has approved their tax risk management approach, compared to 76 percent globally.

68% of Japan-based tax departments have a board-approved strategy that aligns with their overall business strategy, compared to **77%** globally

54% of these strategies were developed with guidance from boards or corporate leadership, compared to **73%** globally

The lack of emphasis on tax governance and tax risk management may stem from differences in attitudes toward tax between Japanese taxpayers and those in other countries. Philosophically, Japanese corporations used to operate with the objective of producing wealth for their societies overall, while most other corporations focus on producing wealth for their shareholders. Because of this attitude, companies in Japan historically considered tax as a contribution to society to take pride in, rather than as a cost to be managed. There is much less focus on tax planning and less tax risk to manage as a result.

Nevertheless, Japan-based companies may be missing opportunities to derive more value from their tax departments. With little board involvement in tax matters, companies based in Japan are less likely to have formal benchmarks in place to set targets for and measure the tax department's performance. Regarding whether their company had set key performance indicators (KPI) against various tax department priorities, 74 percent of respondents from Japan say they have KPIs related to financial reporting and tax return compliance (compared to global results of 80 percent and 76 percent respectively), and only 48 percent have KPIs related to managing tax risk (compared to 72 percent globally).

More focus on tax risk and planning is expected in the future as Japanese-based companies expand into new markets and take on more regional, multinational structures. The more advanced Japan-based companies in this regard are coming to understand the importance of managing their taxes on a global basis. They are also bearing more scrutiny from tax authorities in Japan and other nations, particularly in the transfer pricing area.

While tax audit and controversy reported by Japanese respondents is still comparatively low, it has risen markedly in the past three years: the percentage of Japan-based respondents say they are involved in country-based (federal) corporate income tax disputes rose from 6 percent in 2009 to 28 percent in 2021, while reported indirect tax (sales/use or VAT/GST) disputes climbed from 4 percent to 12 percent.

Given the heightened reputational issues involving the payment of corporate taxes in Japan, the rising levels of tax audit and controversy activity are expected to draw more board-level attention to tax governance and risk management in the future.

Additionally, while some Japan-based companies have centralized their tax departments in the past three years, centralization is occurring at a much slower pace than it is for other companies. Centralization can help clarify accountabilities and ensure clear reporting lines. Currently, 38 percent of Japan-based respondents say their company has a headquarters tax department that directs, manages and coordinates the global tax department, up from 10 percent in 2009 but well below the global average of 76 percent.

Japan-based respondents also are less likely than their global peers to report having employees with tax responsibilities for particular regions or multiple countries (20 percent in Japan versus 52 percent globally) and for single countries (44 percent versus 54 percent globally). Despite the prevalence of business unit structures in Japanese businesses, only 38 percent of respondents say they have employees with tax responsibilities for business units or divisions, compared to 55 percent globally.

80%
of Japan-based tax departments have KPIs to measure timely and accurate tax compliance and financial reporting

48%
have KPIs related to managing tax risk

11%
of Japan-based tax departments are currently involved transfer pricing controversy, compared to **26%** globally

54%
are not currently involved in any tax controversy, compared to **38%** globally

38%
have a centralized headquarters tax department, compared to **76%** globally

Driving efficiency – missing out on the benefits of standardization

Perhaps a result of their tax department structures, Japan-based respondents are less advanced in the standardization of tax departments and tax compliance activities than their global counterparts. Only 22 percent have global standards related to tax policies and procedures. The most standardized areas of global tax departments for Japan-based companies are in tax staff accountabilities, tax processes and technology. However, Japan-based respondents give lower rankings to levels of standardization in these and other areas than their global peers.

In terms of the annual tax compliance cycle (from forecasting through financial reporting, filing of returns and reconciliation), Japan-based respondents report higher levels of standardization across the compliance cycle, although these results also are now below global averages. Japan-based companies approach taxes on a country-by-country basis, rather than globally.

Further improvement of tax department activities and processes does not appear to be a high priority. Currently, 48 percent of Japan-based tax departments are or will undergo an overall tax strategy and operational review, compared to 62 percent globally. Similarly, 30 percent of Japan-based respondents say they have process-related improvement projects in progress, compared to 61 percent globally, and only 22 percent are engaged in or plan to undertake technology-related improvements.

Compared to the global peers, Japan-based tax departments are also making less use of outsourcing, co-sourcing 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, 26 percent of respondents from Japan say they use outsourcing to carry out or support tax department responsibilities, compared with 34 percent globally and 10 percent rely on other finance resources for this purpose, compared to 25 percent globally. And while 30 percent of global respondents say they use finance or accounting shared service centers to support the tax department, no respondent from Japan reports using these structures for tax department activities.

Interestingly, the one-quarter of Japan-based companies that outsource tax department activities are making much more use of third-party providers than they did in 2009. For example, 62 percent of these companies say they outsource corporate income tax compliance work (27 percent in 2009), 54 percent outsource corporate income tax provision work (18 percent in 2009), and 46 percent outsource indirect tax compliance (0 percent in 2009). These results indicate that some Japan-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.

Promoting connectivity – remains low on the agenda

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. As noted, Japan-based companies tend to operate in business unit structures, which limits the ability of tax departments to regularly engage with their colleagues in other departments across the business.

However, Japan-based companies do not appear to be putting a priority on improving the connectivity of their tax teams. Integration with business groups and early indication of routine transactions were among the lowest-ranked priorities, taking a back seat to compliance and financial reporting activities in driving tax department objectives and performance measurement.

Japan-based respondents say they expect to spend 24 percent of their time on financial reporting activities in the next 12 months and 20 percent on tax compliance activities. By contrast, Japan-based respondents expect their tax departments to spend only 6 percent of their time on these activities in the next 12 months. Other value-adding activities are also afforded less time and priority: 9 percent of time is expected to be spent on optimizing the effective tax rate (ETR), and the same amount is expected to be devoted to cash tax planning and tax deferral.

Further, in light of rising tax audit scrutiny and controversy in Japan and other markets, it seems likely that tax departments in Japan will have to devote even more time to compliance and managing tax audits in the future than they do now, especially given the mounting pressure to reduce costs in the current economic environment.

However, most Japan-based respondents seem satisfied with the way things stand: 76 percent of Japan-based respondents believe their administrative budget is sufficient, and 68 percent believe the level of investment in technology and tax process improvement in their tax department is "just right". Only 10 percent of Japan-based companies expect their tax department structure to change in the near future.

As compliance burdens and pressure to cut costs continue to rise, Japan-based tax departments will find it ever more difficult to integrate with their colleagues across the business to provide effective, real-time support to business activity and influence the bottom line. By taking action to improve the department's connectivity, by centralizing and standardizing their tax processes and controls, and by better measuring and communicating their contributions to the business, tax departments in Japan can have significant opportunities enhance their value and profile within the company.

54%
of Japan-based tax department is expected to be spent on tax compliance, financial reporting and managing audits

24%
of time is expected to be spent on optimizing ETR, cash tax planning and integrating with the business

76%
of Japan-based respondents say their administrative budget is sufficient

10%
expect their tax department to be restructured in the near future

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 departments and identifying operational benchmarks for high-performing tax teams.
- For the current survey, 1,150 heads of tax in 22 countries, including 50 respondents from Japan, took part in blind telephone surveys to share their opinions on how tax departments are adapting to current business challenges. About 700 of 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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