KPMG

cutting through complexity

TAX

Good, Better, Best

South Korea

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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. Globalisation continues to spur centralisation 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 South Korea

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

- **Attracting more interest and guidance from boards and upper management** in the development of tax department strategies that are consistent with the company's broader objectives, in part due to rising tax complexity stemming from their increasing foreign investments and regional expansion.
- **Improving tax department oversight by centralising management and direction of the global tax responsibilities** within headquarters tax departments and by making more employees responsible for managing tax compliance for multiple countries and regions.
- **Decreasing their use of outsourcing to support tax department activities,** especially related to international taxes, and potentially missing opportunities to free up tax department time to engage in other, more strategic activities.
- **More focused on compliance, reporting and managing tax audits than other activities,** which limits their ability to collaborate with other departments and help with decision-making and other activities that add value across the organisation.
- **Facing future challenges from rising compliance needs and international tax complexity,** which could draw ever more time and resources from value-adding pursuits in the absence of greater investment in improving tax department processes and efficiency.

KPMG International's series of global benchmarking studies show that leading tax departments – those that add the most value to their businesses – do so by putting high priority on three areas:

1. clarifying accountabilities
2. driving standardisation and efficiency
3. promoting connectivity with their colleagues across the business in support of a proactive tax department.

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

This report highlights insights on how tax departments based in the South Korea have advanced since our last survey in 2009. For analysis of the global survey results, visit kpmg.com/goodbetterbest.

Clarifying accountabilities – rising foreign investment draws attention to tax

Previous KPMG tax department benchmarking studies have shown that leading tax departments put priority on ensuring tax department's roles and responsibilities are clear and commonly understood within the context of a company-wide, board-approved tax governance framework. Compared to 2009, more multinational companies based in South Korea have a tax strategy that is consistent with the company's overall business strategy – 84 percent of respondents in South Korea report having such a strategy currently, an increase from 63 percent in 2009. However, this result is below the current average global result of 93 percent.

84%
of South Korea-based tax departments have a board-approved strategy that aligns with their overall business strategy

Since 2009, the level of board involvement in tax strategy development and governance has greatly increased. The percentage of respondents in South Korea who say their tax strategy has board-level approval climbed from 47 percent in 2009 to 78 percent. Further, 66 percent say their board and/or corporate leadership are directly involved in providing guidance on the tax strategy – a significant increase from 2009 (40 percent).

66%
of these strategies were developed with guidance from the board and/or corporate leadership

These results indicate that, as South Korea-based businesses increase their foreign investments, their corporate leadership recognize the importance of ensuring their financial and tax department processes are in line with their globalization strategies, now and in the future. At the same time, larger South Korean businesses are more aware that non-compliance with tax laws may pose a threat to their company image. Their corporate leaders are putting more emphasis on maintaining their reputations and protecting their by taking a more proactive approach to identifying and managing domestic and foreign tax issues.

For example, the majority of respondents in South Korea have sought to clarify accountabilities and improve the efficiency of their global tax management processes by establishing centralized tax departmments. The percentage of respondents who say their company has a headquarters tax function that directs, manages and coordinates the global tax function rose from 17 percent in 2009 to 62 percent currently.

An increasing number of these respondents now have employees with tax responsibilities for particular regions or multiple countries (44 percent currently, compared to 13 percent in 2009), and 77 percent of these employees report directly to the headquarters tax department, rather than to regional finance and accounting or other personnel. Additionally, 60 percent of South Korea-based respondents say they now have global standards related to tax policies and procedures (23 percent in 2009).

62%
of South Korea-based respondents have a headquarters tax department, up from **17%** in 2009

60%
have global standards for tax policies and procedures

Driving efficiency – Standardising processes and leveraging sourcing options

Our previous research identified a focus on standardisation to automate and strengthen tax processes and controls as a key characteristic of leading tax departments. Compared to their global counterparts, respondents in South Korea report slightly higher levels of standardisation of their tax departments globally in many areas. Technologies are reportedly the most standardised areas, followed by controls and responsibilities and accountabilities of tax personnel. In terms of the annual tax compliance cycle (from forecasting through financial reporting, filing of returns and reconciliation), South Korea-based respondents report levels of standardisation similar to those of their global peers, and standardisation in these areas has increased since 2009.

34%
of South Korea-based respondents outsource tax department activities

Like their counterparts in many other countries, South Korea-based tax departments have room for improvement in their sourcing models, for example, by making more strategic their use of outsourcing, co-sourcing and shared service centres. Currently, 34 percent of respondents in South Korea say they use outsourcing to carry out or support tax department responsibilities, which matches the global average, while 28 percent use a finance or accounting shared service centre to support the tax department (30 percent globally).

28%
use shared service centres for this purpose

Interestingly, South Korea-based companies that do use outsourcing are making more use of third-party providers for certain tax department activities than they did in 2009. The type of work outsourced that saw the biggest increase since 2009 was related to tax planning and business support: 53 percent of these companies now use external advisers for this work, compared to 25 percent in 2009. Outsourcing of indirect tax compliance and corporate income tax provision work also increased, but outsourcing of all other types of tax work, including international tax work, has declined.

These results suggest that many larger businesses in South Korea are focusing on their international tax issues by investing in the hiring and training of internal tax professionals to handle their international tax issues rather than relying solely on outside service providers. In doing so, they may be missing opportunities to use outsourcing and shared service centre structures strategically to free up in-house resources for other activities. Outsourcing also offers opportunities to access leading practices, specialized knowledge (e.g. in areas such as transfer pricing) and investments that cannot be developed in-house.

Promoting connectivity – compliance work favoured over other activities

Connectivity with other parts of the business is crucial for tax departments to achieve their full potential as contributors to business strategy and drivers of value. Among South Korea-based respondents, tax compliance and financial reporting activities take priority over value-adding activities. While effective tax compliance is critical, the focus on these activities means that integration with business groups and early indication of routine transactions are given less priority, both in terms of how the tax function is measured and where tax function time is expected to be spent.

When asked where they expect their tax department would devote its time over the next 12 months, respondents in South Korea gave the highest rankings to tax compliance and financial reporting. These activities are expected to occupy 21 percent and 23 percent of tax department time respectively. These respondents also expect to devote 13 percent of their time to managing tax authority audits.

On the other hand, integration with business groups and early indication of non-routine transactions ranked low in priority, expected to occupy only 5 percent of tax department time. Other value-adding activities – like optimising the effective tax rate (7 percent) and cash tax planning (9 percent) – also are expected to take up less time.

Unfortunately, it seems likely that South Korean-based tax departments in future will need to devote even more time to tax compliance activities, especially in their time spent dealing with tax authorities. South Korean tax authorities have increased both the frequency and level of scrutiny of tax audits, sharpening their focus on outbound investments and foreign related-party transactions.

Despite these initiatives, tax controversy reported by respondents in South Korea has increased since 2009 in several taxation areas. For example, 36 percent of respondents in South Korea are involved in disputes over country-based (federal) corporate income taxes (3 percent in 2009), and 12 percent are involved in indirect tax (sale/use or VAT) disputes (10 percent in 2009). Overall, 54 percent of South Korea-based respondents are involved in some form of tax controversy.

Rising tax audit activity, combined with the compliance challenges that come with regional expansion, means that South Korea-based tax departments may have to devote even more time and resources to compliance than they do now, leaving less time and resources to provide effective, real-time support to business activity and influence the bottom line.

However, for the majority of respondents in the country, there appears to be little interest in improving tax department processes in order to meet these challenges. Compared to their global counterparts, few tax department projects are in progress or under consideration to improve processes (6 percent versus 61 percent globally), technology (12 percent versus 53 percent globally), or staff training (28 percent versus 61 percent globally).

57%
of South Korean-based tax departments' time is expected to be spent on compliance, reporting and managing audits

21%
is expected to be spent on optimizing the effective tax rate, cash tax planning, business integration and early indication of non-routine transactions

Over 1/2
of South Korea-based respondents are currently involved in some form of tax controversy

72%
are satisfied with their current tax administration budgets

Only 6%
expect their tax department to be restructured in the near future

Additionally, 72 percent of respondents in South Korea are satisfied with their current administrative budgets (53 percent in 2009), 90 percent are satisfied with levels of investment in tax technology and process improvement (70 percent in 2009), and only 6 percent expect the structure of their tax department to change in the near future (13 percent in 2009).

In light of the challenges ahead, forward-thinking tax directors in South Korea should be considering their business case for additional tax process and technology improvement. By doing so, they stand to gain benefits in terms of greater visibility and control over compliance and reporting processes and improved quality. Just as importantly, they can free up resources to focus on higher value strategic and business support activities that are currently being neglected, allowing them to become more effective and proactive business partners that add value and influence the bottom line.

Blueprint for change

As tax departments struggle to cope with mounting regulatory and cost pressures, leading organisations 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 realise 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 labour-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 South Korea, 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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