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Tax Function Survey Report

June 2009

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Affecton: the tax team. A consulting service dedicated to improving the direction, performance and reputation of in-house tax teams.

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Introduction

In these uncertain times, it is comforting to reflect on Benjamin Franklin's observation that death and taxes are the certain companion to the human condition. Comforting that is, for those of us involved in tax, as there will always be useful employment for some, in sorting out tax's complexities.

Tax complexity is now greater than it ever has been; in large part due to the increased complexity of business operations. For the Tax Function, increased complexity has meant trying to minimise the restrictions that tax puts on Business, while ensuring that Business meets its tax obligations.

Today, Business is under much greater scrutiny. And with scrutiny comes a demand for transparency and an accountability for Chief Executives and "Senior Accounting Officers" for all the Business's actions. The Tax Function is no longer allowed to run tax on its own; Management and others want to know much more about what, and how, things are done. This move from a "trust me" world to a "show me" world is propelling Tax Functions on a journey.

This journey is moving the Tax Function into the Business's ordinary operations; making the Tax Function a strategic partner to the Business as opposed to just a specialist advisor. Thus, Tax Functions are becoming far less insular than they once were and are becoming more like other functions within the Business. Tax Functions are using standard business and management tools so that tax risks are managed like any other business risk and are disclosed transparently in ways other business people can understand.

Furthermore, pressure grows on Tax Functions to justify their performance relative to their peers; as well as demonstrate the value they deliver and how efficient and effective they can be in managing tax.

It was with this in mind that we undertook our first Tax Function survey in 2002. What we found, however, is that each Tax Function is unique; each operating as part of a diverse business that is culturally, organisationally and geographically specific to each group. A comparison of relative performance is, therefore, not feasible. Nevertheless, we can contrast the different ways Tax Functions are organised and managed and share what we perceive as good practice. That is what we aim to do here.

Our survey covers companies from the top of the FTSE to the bottom; with Tax Functions ranging in size from over 500 to under 10 tax professionals. We have covered 57% of the FTSE by value. The survey was conducted in face-to-face meetings with Tax Directors and senior members of Tax Functions in 2008 and 2009, with survey questions being framed to elicit objective facts and develop a dialogue around issues of importance to Tax Directors in managing their Tax Function. In the Report that follows we have attempted to convey the essence of these discussions, together with our analysis and conclusions. We have also included a Detailed Findings section with answers for each question, in order to provide a more complete picture of what we found.

Lastly, and most importantly, we would like to express our gratitude to all those who participated in this survey. Your generosity in time and thought is much appreciated. We hope that your efforts are rewarded through this Report being useful to you on your own particular journey.

Survey Report

Tax Function Model

The Affecton Tax Function Survey compares the organisation and management of Tax Functions covering the areas of governance, structure, processes and people. To provide a framework for this comparison, we have developed a model to show the relationship between the various aspects of a Tax Function. Our model is presented in Exhibit 1. Our model has four inter-related areas namely: policy; direction; performance; and reputation and a Tax Function needs to balance and perform each of these well in order to be effective overall.

- **Policy** is the framework of principles to which the Tax Function adheres. This can be recorded in a specific tax policy or a company-wide policy that applies to the Tax Function.
- **Direction** is what the Tax Function has been tasked to achieve and the strategy and leadership it uses to achieve agreed objectives.
- **Performance** is the tactical approach adopted to achieve the Tax Function's objectives, primarily covering the organisation and management of resources (mainly people) and processes that deliver results.

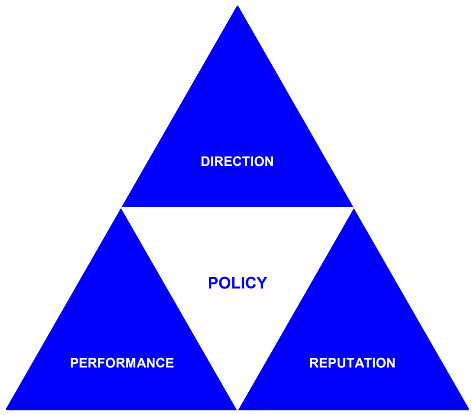

Exhibit 1: Affecton Tax Function Model.

- **Reputation** is the quality of the relationships which the Tax Function enjoys and which thus earns it a seat at the table – relationships with the Finance Director and Board; the Business which the Tax Function services; and external parties including investors, Revenue Authorities, corporate regulators, governments and auditors.

We have used this model as a basic structure around which to discuss our survey results.

Policy

By a "Policy" we mean a document recording the scope of the Tax Function's responsibilities to the group it serves and the people who work in it. The policy normally sets out standards of professional and ethical behaviour, levels of acceptable risk, levels of disclosure and required controls. As the ethical framework for the Tax Function, a tax policy supports the alignment of individuals to core corporate values and beliefs.

Policy is now an area with much greater formality than in previous years. In 2002, when we asked Tax Directors about their tax policy, they often talked of an "understanding" built on professionalism and broad ethical policies. Today, most groups have a formally documented and approved tax policy or are in the process of developing one. In some cases the policy is shared widely within the group and, in a few cases, even externally.

This focus on policy is in response to two main forces for change. First and foremost, the increased level of controls flowing from Sarbanes-Oxley; and, secondly, the "Tax in the Boardroom" agenda, taken up with vigour by HMRC. Apart from the obvious increase in the quantum and extent of the controls applied to tax, it is unclear whether these forces have particularly affected the strategic direction of the tax policies adopted.

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For example, we asked Tax Directors what, in their view, was the “right” amount of tax to pay. Most groups follow a “letter of the law” rather than “spirit of the law” approach. Perhaps this is unsurprising since no one said they would ever act in a way against the law and so a “spirit of the law” approach always biases against the taxpayer as one can never access the benefits of those situations where the “spirit of the law” says something should be deductible but the letter of the law precludes it. The few groups that do adopt a “spirit of the law” approach did so on the basis that commercial benefits (perhaps from perceived risks to some form of government licence or concession) outweighed any additional tax cost. Arguably, both sets of companies are acting rationally to maximise their overall position.

It is also interesting to see whether the debate about “letter of the law” versus “spirit of the law” is impacting on the tax planning methods used. We asked Tax Directors to estimate the use of “boxes” versus “business/tax alignment” styles of tax planning now and in the future (“boxes” typically involve more types of planning contrary to the ”spirit of the law”). The responses are shown in Exhibit 2.

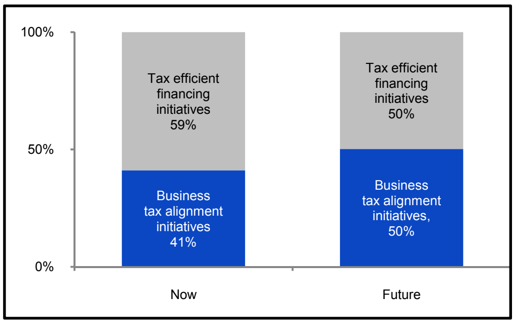

Exhibit 2: Tax Planning Initiatives

In the future, the expected split between “boxes” and “business/tax alignment” styles of tax planning is trending slightly towards more “business/tax alignment”, although the overall trend is, perhaps, small. More interesting are the individual trends. Some Tax Directors predicted a shift away from “artificial” tax planning (generally associated with the “boxes” styles of planning) towards more business aligned tax planning; while others felt the pendulum was about to swing back towards more structured tax planning after an overreaction to the Revenue’s aggressive crackdown on tax avoidance - the legal form, that is!

Notwithstanding differences in the form and content of individual tax policies, there was little consistency in the extent of tax staff engagement in the development and understanding of the tax policy.

Very few groups seriously engaged in a dialogue or debate with Tax Function staff about what the tax policy is or should be. This seems to be a missed opportunity for groups to involve and motivate Tax Function staff in what should be matters of importance and direct relevance to them. As has often been stated “no involvement, no commitment” – staff involvement in framing tax policy should therefore be a priority given its increased importance (particularly as applied to managing risk).

We see three major benefits in engaging staff more in developing and understanding tax policy:

- individuals will know better what is expected of them in difficult situations, where they have been involved in framing tax policy and understand it well. Without such engagement, decisions may be ineffective or inappropriate;
- an understanding of tax policy helps to improve Tax Function performance by providing context and meaning to what the Tax Function is and stands for. Research on the motivation of teams, shows that increased meaning improves team performance. Further, you can never have too much meaning - meaning improves team performance ad-infinitum; and

- working together on tax policy helps members of the tax team deal effectively with complexity which is in the nature of tax. Low levels of shared understanding produce errors because not all the attributes of a particular issue are appreciated. High levels of understanding allow team members to make creative connections between ideas and issues. This is because team members understand and share common expectations, values and beliefs. Engaging the Tax team in developing tax policy is an opportunity to increase this shared understanding.

Direction

In "Direction" we look at what the Tax Function is tasked with achieving and how it intends to go about it. Direction is made up of three main areas: objectives; strategy and leadership, all of which need to be done well. While these areas are interdependent, the starting point is a clear set of objectives. The strategy required to achieve the objectives then follows and after that the leadership (and management) of the team to achieve the strategy.

Objectives

Objectives provide the creative tension within the team to drive the effort necessary to achieve high performance goals – without clear objectives there is no need to strive to meet stretch targets. Further, clear objectives can be better measured allowing performance to be better managed.

Our survey highlights some interesting aspects in relation to Tax Function objectives. Firstly, there is a broad consistency between the top rated objectives in our current and 2002 surveys; albeit that in 2002 we used an open question to elicit responses, compared with the ranking question in the current survey – see Exhibit 3.

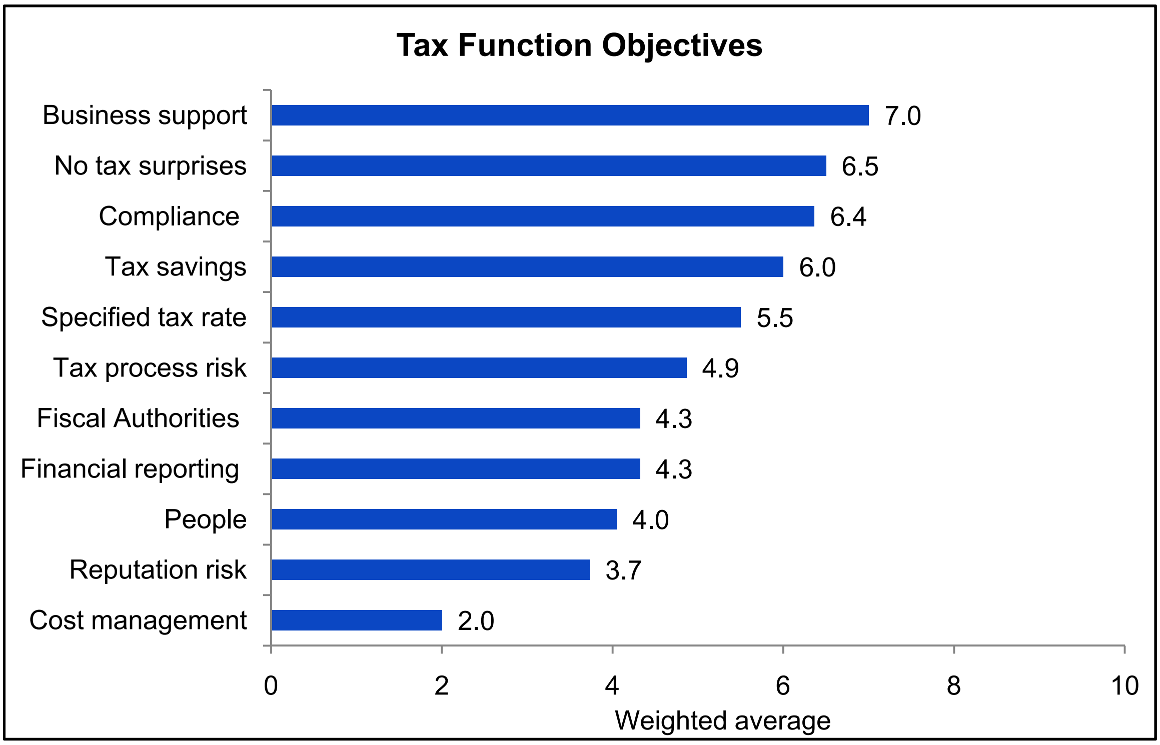

Exhibit 3: Tax Function Objectives

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Secondly, there is no one objective that is clearly most important to every Tax Function. Business Support, which is the highest rated objective, is not unanimously first. Indeed, No Tax Surprises was the objective most often put in Tax Directors' top three – but it is also well represented in Tax Directors' bottom three objectives too! A similar spread of responses exists for the other highly rated objectives with the exception of Specified Tax Rate (which was also typically rated either very high or very low) – see the Detailed Findings commentary for Questions 1 for more information. This suggests the primary purpose of Tax Functions may differ between groups or there is a lack of clarity as to what the primary purpose is.

Thirdly, there is little consistency in how the achievement of objectives is measured (with a small number of Tax Functions not even measuring outcome at all). The only objective to be consistently measured was Tax Function Cost. But this objective was regarded as the least important and so the fact that it is most often measured probably only reflects its relative ease to quantify. Business Support was the top rated objective and, while some Tax Functions have structured customer surveys to help measure how they are doing, most Tax Functions did not have more than informal approaches, such as face to face meetings, to measure delivery against this objective.

Other objectives which were often quantitatively measured include meeting Compliance requirements and achieving a target Effective Tax Rate. Even apparently quantitative targets such as Tax Savings were normally subject only to informal reporting routines (because of the difficulty of establishing a meaningful reference point against which actual tax savings "achieved" could be measured). Most objectives, and in particular the highest rated objectives, were therefore generally monitored using only informal and subjective measures of performance.

Overall, our survey responses suggest there may be scope to improve Tax Function performance through the implementation of more formalised processes of setting and measuring objectives, in order better to align people's behaviour with those objectives.

Strategy

The "Strategy" is the means by which the Tax Function plans to achieve its objectives. Most Tax Functions, significantly more than in 2002, now have a strategy as shown in Exhibit 4.

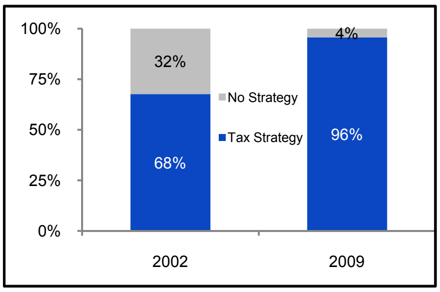

Exhibit 4: Tax Strategy

Despite most groups today having a tax strategy, we found major differences in the scope of those strategies and how they are implemented. For some groups, their strategy is a sophisticated tool actively used to manage the Tax Function. It covers objectives, roles and responsibilities, an action plan, and a risk framework. For other groups, the tax "strategy" is a static document broadly summarising what the Tax Function is tasked with doing which can be more like a policy document than a strategy.

Generally, the larger Tax Functions are more systematic in the way they develop, disseminate and implement their tax strategy. Nevertheless, they still show a variety of approaches to their tax strategy – no one approach was consistent between Tax Functions. This reflects differences in culture, management policies and systems as well as individual approaches adopted by the Tax Director and historical practices developed over time within the Tax Function.

We found smaller Tax Functions were often less formal in their approach to strategy; probably reflecting the greater level of direct day-to-day interaction that is possible within smaller teams.

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Leadership

With leadership we include “management” as an essential complementary feature – leadership articulates a vision for the future, while management ensures that those things that need to be done are achieved. All Tax Directors we met act both as leaders and managers although the emphasis in style between leadership and management varied, reflecting individual preferences.

All Tax Directors identified leadership as an important factor in the successful management of their Tax Function. Communicating a clear vision and articulating specific objectives were, in particular, noted as helpful in providing a shared sense of direction and travel on the journey. This vision needs to be consistently articulated and repeated so that goals are frequently reinforced and people always know what is expected.

In leading the Tax Function, most Tax Directors also emphasised a need for good communication with the Business, Finance Director and Board. Often the Tax Director has an important facilitator role between the Tax Function and the Business. This is to ensure an effective alignment with group strategy and that the Business understands what the Tax Function can offer and the Tax Function understands what the Business needs. The Tax Director therefore needs to be adept in listening and understanding the needs of the Business and articulating this back to the tax team. In some situations the Tax Director must also bear external pressures from the Finance Director or Business, while steadying and guiding the tax team.

As with the variety in tax strategies adopted, there is considerable variety in how different Tax Functions are managed. An interesting feature of this variety was that there is no specific key performance indicator common to all Tax Functions; indeed most Tax Functions do not have a formal management system using key performance indicators. Also, those Tax Functions that do use key performance indicators mainly track outcomes already achieved rather than use leading indicators which might give better warning of impending problems. The most common key performance indicators used are:

- monitoring tax rate, cash or effective tax rate (over 40% of respondents);
- compliance statistics – speed and proportion filed (over 40%);
- balanced scorecards or similar processes to monitor performance against objectives (approximately 30%); and
- monitoring penalties and tax audits (approximately 20%).

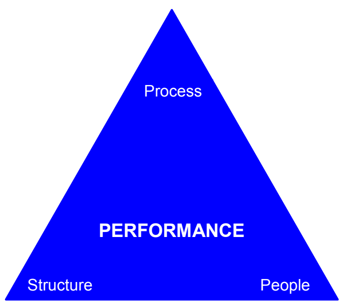
Of the many approaches to managing the Tax Function, there were some examples of good practice which respondents found particularly effective for their organisations. These included:

- an annual planning process, culminating in a formal planning meeting, to prioritise projects for development and implementation in the coming year. Tax team members propose and sponsor projects which are then assessed and weighted based on: financial benefit, risk, cost and ease of implementation and time to completion. The projects finally agreed upon are then tracked and monitored by a “project management office” having a dedicated project manager skilled in driving implementation together with a process of regular senior tax team review and decision-making via conference calls and face-to-face meetings;

- a tax executive committee to support the development and implementation of key objectives. Wider tax team and finance representation is included (as appropriate to the agenda) to link agreed objectives to implementation by the teams in tax or finance;
- a committee of Financial Controllers to support the implementation of tax initiatives and reinforce tax controls within the Business. The key to making this approach successful is to engage the Financial Controllers on the common benefits around tax control and effective tax processes. The Financial Controllers also had key accountabilities for tax: this may be a delegation too far in how some groups want to manage their tax;
- a formal balanced scorecard of key objectives for tax that are aligned to the Finance Director's objectives for the year. With broad guidance from the Finance Director, the balanced scorecard is developed by the senior tax team (with input from the wider team), broken down to sub-processes and then objectives were cascaded across the whole tax team with individual accountabilities for specific objectives. This approach provided a clear link between individual team objectives and high level strategic requirements;
- a long term financial model for the tax rate of the current and following ten years. The model is regularly updated for changes in business forecasts and tax assumptions; and
- quarterly off-site meetings (1-3 days) of the senior tax team to plan, review progress and agree priorities for the next quarter. Progress is measured against key performance indicators including risk weighted exposures and milestones in the planning, reporting and compliance cycle. The key performance indicators are regularly monitored via a tax dashboard - a customised piece of software integrated into group reporting systems.

Overall, we have seen Tax Function management become much more sophisticated since our first survey in 2002. Then, there was more emphasis on meeting the challenges of tax technical uncertainties. Now, Tax Directors need much broader skills in managing the team, the management of risk and communicating with stakeholders outside the Tax Function. We see this as a reflection of tax's need to become a more "mainstream" function within the groups they serve. Further, tax people are now more able to become future leaders within the wider organisation – many groups are encouraging tax people to move into general management roles, even if only for a short period. Tax Functions are also taking in more generalists: dedicated Financial Controllers, IT specialists, HR specialists – even Tax Directors who do not have a tax background!

Performance



By "Performance" we mean everything a Tax Function does to achieve its objectives, principally through people operating processes within a structure.

People

People are the Tax Function's main resource. They are the driving force for all that the Tax Function performs. Tax is complex and people are needed to interpret and manage this complexity – even though standardised processes, less dependent on individuals, are being developed.

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Tax Directors saw people management as their greatest challenge although, interestingly, the People objective for Tax Functions was given a low priority by most groups – see Exhibit 3. Approximately 60% of Tax Directors said recruiting, developing, motivating and retaining good people was their number one priority in promoting Tax Function performance.

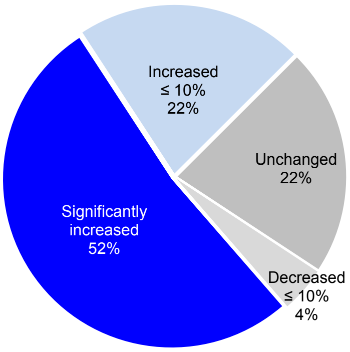

Exhibit 5: Tax Function Budget.

Most Tax Functions have seen a significant increase in their budget over the past few years – see Exhibit 5 – and so has been able to support an increase in professional staff numbers. Even so, nearly 50% of groups reported they were unable to get the right number of people with the required skills. We were told this is due to the growth and changes in the business and technical requirements (particularly in accounting and risk controls) and a shortage of 3-5 year post qualified candidates. We were also told that there is a lack of flexibility in the roles tax people can perform due to increased specialisation. Increasingly, there is a tension between maintaining a high level of tax specialism, while simultaneously developing non-tax skills to interact more effectively with the Business. For most tax professionals, specialist tax skills are the bedrock of their career. Tax staff may question whether greater business integration means that they gain so many non-tax skills, that they begin to lose many of their tax skills; and as a consequence, their ability to advise effectively.

Many Tax Functions struggle to manage their people's career aspirations. This is true in most Tax Functions; even the very largest which are able to offer more scope for role change. Some 50% of Tax Directors rated training, coaching and employee satisfaction as currently less than optimal in terms of achieving high performance (Training & Development, Long-term Orientation and Coaching being the worst three areas Tax Directors assessed about the features of their Tax Functions – see Exhibit 10). Yet in many cases Coaching and Training were, surprisingly, a low priority for Tax Functions – the average number of training days across all Tax Functions was only five. It appears that most Tax Directors see this as an important issue but are struggling to resolve the dilemma. There is a lack of clear career paths (particularly in smaller Tax Functions) and a lack of formality in how key people are developed. For many tax staff advancement therefore means leaving their current Tax Function and, probably, the group they work for. In this situation it is difficult to build a long lasting alignment of personal and corporate objectives.

Encouraging and developing tax staff where there is little scope for advancement is one of the biggest challenges Tax Directors face – how to maintain continuity and enthusiasm without stagnation and apathy. We felt some groups chose not to highlight this difficult area as it only emphasised to staff their predicament. While no one has identified a simple solution to this problem, examples of some useful approaches included:

- rotating staff through different roles within the Tax Function (while simultaneously managing the issues around specialisation);
- secondments overseas or in another business unit (both inside or outside the Tax Function);
- identifying high potential staff and tailoring individual development programmes;
- structured training, typically involving an outside firm. Some groups have a comprehensive training programme covering both tax technical and management skills;
- allocating people to key group-wide initiatives – for both tax and wider business projects; and
- engaging staff in developing tax policy and contributing to performance improvement objectives.

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Overall, the focus on people has grown in importance since our first survey and this now appears to be the area with the greatest potential to deliver increased Tax Function performance. Most Tax Directors acknowledge the need for improvement in people management but struggle to find the answer. People will be central to the long-term success of the Tax Function. However, in the short-term, it will also be interesting to see how the focus on people is affected by the financial crisis (many of our interviews were completed in 2008 before the full impact of the credit crunch was widely felt).

Processes

Since our 2002 survey, Tax Function processes, particularly those for delivering compliance, reporting and controlling risk, have become more formalised and sophisticated. This is being driven not only by the need for greater reliability to meet Sarbanes-Oxley and Fiscal Authority requirements, but also because it represents the route to cost savings in the longer run.

Compliance and reporting are the main areas of activity within the Tax Function, using nearly half of the people resources available – see Exhibit 6.

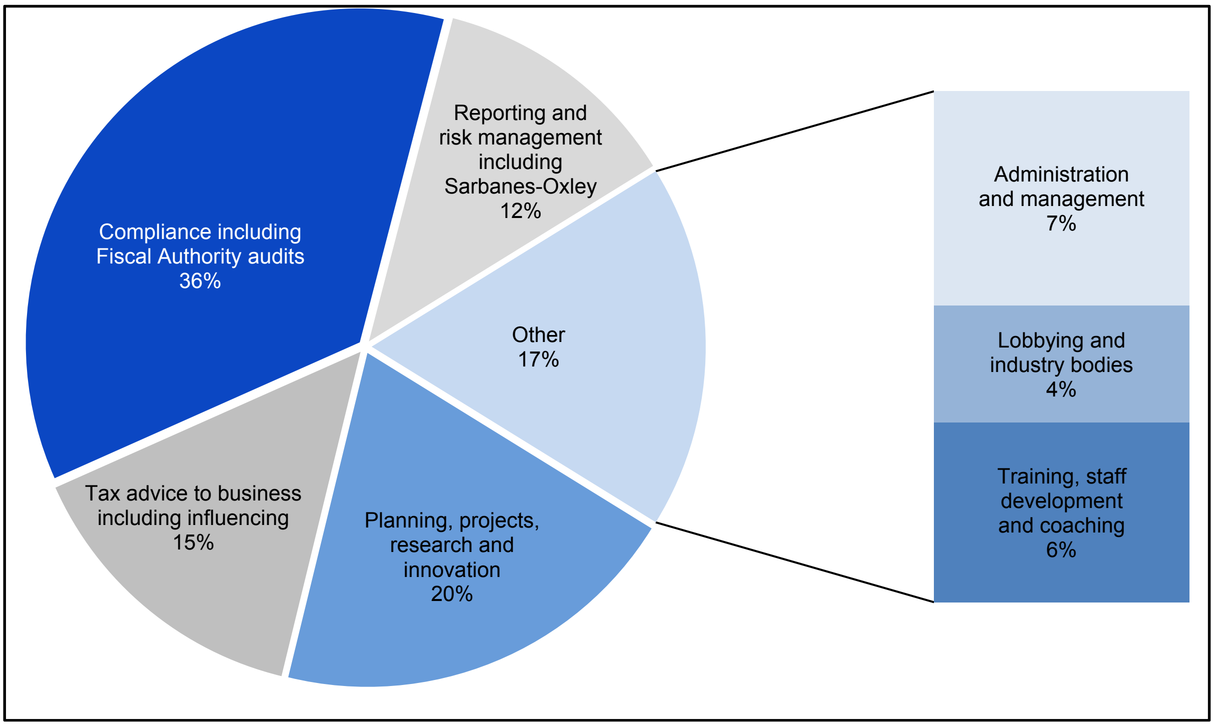

Exhibit 6: Allocation of Tax Function time spent.

Most Tax Directors said, ideally, they would like to reduce the time spent on compliance and reporting and increase time spent on planning (although the gap between the actual allocation of time and the stated ideal allocation was, actually, quite small). Several Tax Functions reported developing comprehensive procedures manuals covering every aspect of the Tax Function with a view to making their processes more efficient, effective and reliable. The development of such a procedures manual is, effectively, an exercise in defining and recording processes – generally this is an essential prelude to any effort to reduce compliance burdens.

A major challenge in streamlining compliance processes is the bottleneck at the interface between the accounting system/finance function and tax. Typically there are problems here with incomplete and incorrectly formatted data driving a need for extensive Tax Function reworking and reconciliation of data. Thus, another approach to streamlining compliance processes is the automation of compliance processes (following their careful definition, recording and assessment). Many groups now seek to drive the analysis their tax computation software requires by linking it directly into the accounting systems or data warehouse to avoid these bottlenecks and data reworks. We found no one who has yet achieved a full level of automation but several groups found their efforts delivered significant improvements in their capacity to complete tax returns on time.

One group has significantly reduced compliance times through system improvements coupled with an agreement with HMRC on materiality levels for tax sensitive accounts.

Outsourcing is another common strategy. Several companies have outsourced part or all of their compliance to third party providers or an internal processing centre. Those who reported success in outsourcing often have widespread international operations with standardised global accounting systems that are already well defined and documented. We also heard some Tax Directors talk about outsourcing as a route to cleaning up their compliance processes. Outsource providers are ruthless in defining and standardising processes in order to maximise their efficiency. Some Tax Functions don't have the resources or expertise to do this for themselves and might consider giving the compliance to an outsource provider in order to get this cleansing done for them. This offers the option of taking the compliance back in house later once it has been systemised, particularly if the outsourcing itself doesn't realise the cost gains expected.

Outsourcing outside the plain vanilla compliance arena is also now being addressed. With the continual pressure on costs, lower value process work is now an area of increased attention and many groups are examining this closely.

There were also a few examples of Tax Functions seeking to improve processes for planning and projects, but this was not widespread. Many Tax Functions rely on their advisors to research and develop innovative ideas and the processes for implementing them and this limits how much the group can do itself.

With the move towards a business/tax alignment style of tax planning we saw several Tax Functions looking to develop more planning ideas in conjunction with the Business and rely less on pre-packaged ideas from advisors. This approach potentially offers a virtuous circle of a closer understanding of, and relationship with, the Business leading to original and innovative planning ideas which, in turn, reinforces the working arrangements with the Business. Teams can achieve outstanding innovations when organised in the right way.

Most Tax Functions now have a formal approach to risk management, typically with tax following the group-wide risk management system, although with additional systems to monitor major tax specific issues. In some cases the Tax Function has also extended its supervision of operational taxes normally dealt with by the Business, often using internal audit style approaches to monitor the Business's controls. These changes have enabled Tax Directors to get much more control over their tax risk, although it is less clear whether such formalised processes have changed how the tax risk for isolated major transactions is managed. It also seems that the increased focus on risk has forced Tax Directors to adopt more formalised approaches in presenting risks to the Finance Director, Board or Audit Committee.

Overall, there have been widespread improvements in the processes used within Tax Functions and in most cases this has led to significant efficiency gains. The emphasis on improving processes is still a priority for many Tax Directors – with the expectation of delivering evermore efficiency gains through reduced duplication of effort and standardised processes that can be automated.

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Structure

The organisational structure of the Tax Function is one of the main challenges facing Tax Directors – how to get the right people, in the right position, with the right level of responsibility.

Achieving the optimum Tax Function structure involves a number of options, often with competing benefits or trade-offs. Selecting the right answers for these options frequently poses interesting dilemmas; choosing which way to jump is difficult since each competing trade-off may have the potential to create significant benefit with there being few or no intermediate compromises able to capture the majority of both benefits.

In our survey we encountered the following potential issues that were often seen as dilemmas:

- a centralised versus decentralised Tax Function;
- specialists versus generalist skills;
- central or hierarchical planning and control versus local autonomy and empowerment;
- fixed roles versus flexible roles;
- geographical versus a business unit focused organisation and accountability;
- internal versus external resources; and
- a hierarchical versus flat organisational structure.

We found no fixed patterns or absolute answers used in reconciling the opposing positions in these dilemmas. Factors generally affecting the outcome selected appear to be: Tax Function size, complexity, geographic spread and the overall management culture of the organisation in which the Tax Function operates. Thus, Tax Functions in smaller, less complex organisations tend to have fewer specialists and more flexible roles. However, the group’s attributes did not account for all the differences. So, for example, there was no clear trend in the use of central or hierarchical planning and control versus local autonomy and empowerment and large complex organisations and smaller simple organisations used both options.

The organisation of the Tax Function by geography or business unit also created many variants. For example there may be an initial division of the Tax Function by business unit with a further geographical sub-division for each business unit. Often some sort of matrix solution was used with both geography and business unit being represented. In these situations we generally found that geography had dominance in the matrix (largely because, at the end of the day, all tax planning has to be turned in to tax computations submitted to country Fiscal Authorities). However, there were still differences in how these conflicting priorities were managed by some companies and over time the solutions chosen oscillated from one extremity to the other.

The use of internal versus external resources is mainly driven by economies of scale and consistency of work requirements. For example, ongoing compliance, financial reporting and day-to-day advice were mostly handled in-house while larger, complex or unusual projects were more likely to be outsourced. The proper use of external consultants is valuable since it enables the Tax Function to concentrate on building certain core skills internally and bring in expertise as and when required. It also facilitates headcount management to shave workload peaks and troughs.

In resolving conflicting options, the route to an optimum solution is often found by a reconciling approach that combines strengths: an "and" rather than an "or" approach. This may not be immediately obvious. It can be illustrated in the case of reconciling specialisation versus integration with the Business.

Specialisation is usually achieved through increasing scale and centralising the Tax Function; with business integration being achieved through co-location of teams or a formal allocation of tax staff to the Business. These alternatives often produce rigid organisational structures where it is difficult to simultaneously reap the benefits that each alternative delivers alone. Most Tax Functions are therefore driven to a choice of one alternative or the other: tending towards higher specialisation at the expense of business integration ("Specialist") or positioning tax people in the Business ("Business Co-ordinator"). However, a few have achieved an optimum "and" answer by organising a network of tax specialists aligned to the Business "Strategic Business Partner" – see Exhibit 7. While this more flexible approach produces good results, it needs careful ongoing management to ensure it does not slip back into either of the extreme alternatives and hence lose its dual benefits. Often this means changing behaviours and in some cases the culture of the tax organisation. This mastering of "soft" skills - which is often hard compared to mastering technical skills which most tax people are used to.

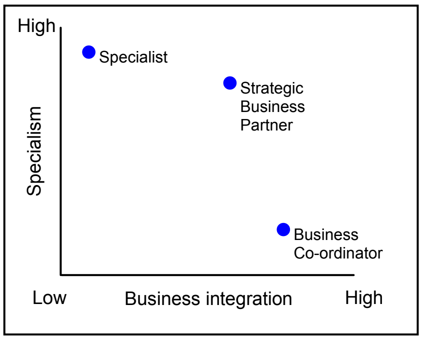
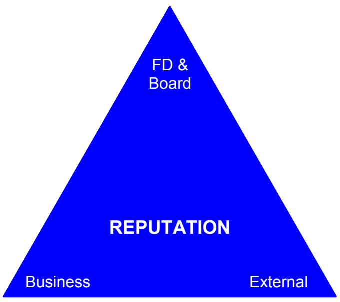


Exhibit 7: Tax Specialism and Business integration

Reputation

Reputation represents the quality of the Tax Function's relationships with key stakeholders and interested parties both within and outside the group. The strengths of these relationships shapes the Tax Function's ability to influence each constituency and therefore to control and shape its own future – will the Tax Function have a seat at the table and a voice in determining its destiny or just be buffeted by external storms? There is therefore interdependence between the Tax Function's reputation and its ability to meet objectives and achieve results.



The three main groups of relationships important to the Tax Function are: Finance Director and Board; the Business; and external parties, including Fiscal Authorities, regulators, industry bodies, governments and auditors. We have not included advisors in this grouping as they represent an outsourced extension of the resources of the Tax Function.

Finance Director and Board

In most groups we met, the responsibility for tax is delegated by the Board to the Finance Director and then to the Tax Director. In a few cases, the Tax Director reports indirectly to the Finance Director through a Financial Controller (or similar) but even in these cases the Tax Director normally has ready access to the Finance Director who takes an interest in major tax issues.

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The Tax Function's relationship with the Finance Director is usually pivotal for two main reasons: the Finance Director is normally the Tax Director's line manager and so directly influences priorities, behaviours and outcomes. Also, the Finance Director usually represents the Board's interest in tax matters (because of tax's complexities, other executive directors rarely take an interest in anything tax related).

The Finance Director's interest in tax (and the thereby the importance of his relationship to tax) is affected by three main factors: tax's importance within the group's financial performance; the need to provide analysts and investors with a high degree of predictability and "no surprises"; and the inherent tax complexity of the group's affairs.

Tax's importance to the Finance Director varies between groups. Most Tax Directors thought Finance Directors were more focussed on post-tax results while Business Leaders were thought to have a pre-tax focus as shown in Exhibit 8. This can be explained by the fact that most groups measure business performance on a pre-tax basis. The nature of certain industries makes it more likely that the Finance Director will be more interested in tax. For example, tax attributes can form an integral part of the commercial service offering (banking perhaps) or can be a significant above the line cost (oil).

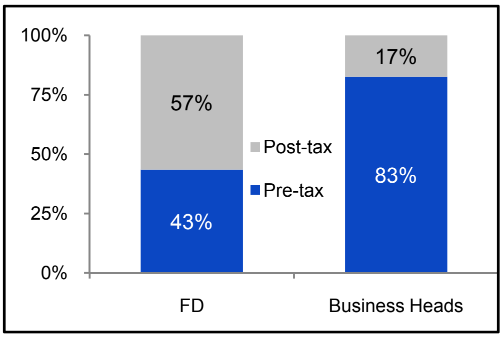


Exhibit 8: Pre-tax, Post-tax split

It was suggested that City analysts are primarily interested in pre-tax earnings (probably because they find tax difficult to really get to grips with and just want a predictive rate to plug into their financial models). A possible result of this was the feeling that there is little difference in the group's rating based on different tax outcomes. This is not to say that tax does not matter: if there is a major unplanned variation in the tax rate it has serious consequences. Not necessarily because of the direct financial impact on the accounts; but rather the loss of confidence in the group's reported numbers or other reputational concerns!

This leads to the second factor shaping the Finance Director's interest in tax – the desire for predictability and certainty. All respondents recognised that "no surprises" is a key priority for the Finance Director and so is reflected as a highly ranked objective for the Tax Function – see Exhibit 3. The introduction of Fin 48 has, in theory, meant that there should be less room for manoeuvre in managing the tax rate (i.e. less scope for a "buffering provision"). This should, in turn, increase the potential for tax surprises. However, in practice this did not seem to be a major issue for any the Tax Functions in our survey.

The third factor shaping the Finance Director's interest in tax is the degree of tax complexity. By this we mean the ability of the Finance Director to grasp key tax concepts and determine what is important in any particular situation. As tax complexity increases, the Finance Director's understanding and engagement on tax issues decreases. Most Tax Directors recognise that being able to communicate complex tax issues in plain English is critically important in increasing the Finance Director's understanding and engagement of tax; as tax complexity increases, the need for effective communication increases. This is presented graphically in Exhibit 9.

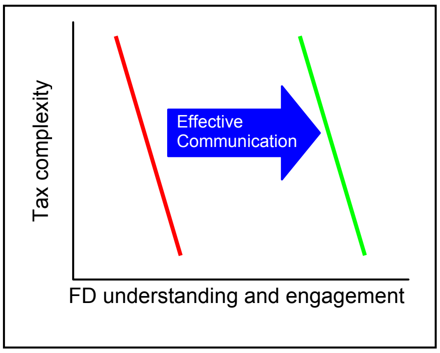


Exhibit 9: Effect of Communication on complexity and understanding.

Survey Report

Overall, it is apparent that Tax Directors are adept at managing the relationship with the Finance Director, taking account of the three forces outlined above. Of these, good communication and managing expectations are seen as the most important - they are more controllable and have the greatest influence on tax decisions and outcomes.

The Business

Supporting the Business is seen as a top priority for most Tax Directors – see Exhibit 3. For this reason it is important to maintain a good relationship with key business leaders – key in the sense that tax interfaces particularly with certain areas of the Business and can add more value to particular business transactions. Typically, these areas are:

- the Finance Director, Board, corporate finance and Business leaders on mergers and acquisitions;
- finance and accounting - mainly in respect of compliance and financial reporting; and
- key business areas for ongoing tax advice.

The extent and depth of the relationship required depends primarily on the nature of the Business, its organisational management and inherent tax complexity. The main issues for Tax Functions in some highly centralised groups relate to corporate financing. In such situations tax mainly needs to be close to the finance function and can survive with relatively little interaction with other business areas. In other groups, tax issues are threaded throughout the fabric of the business operations and tax needs to keep close to a wide range of finance and business personnel.

As noted in the Structure section above, this presents a dilemma in deciding how to structure and integrate the Tax Function into the business and a variety of different approaches exist – for example: co-location, fixed role allocation or flexible co-ordination of relationships.

As noted in Exhibit 8 above, most business leaders tend to have a pre-tax bias. This can make it harder to integrate tax into the Business; not necessarily because the Business will not support tax initiatives but it may not positively seek them out. Most Tax Directors thought the Business's pre-tax bias was only marginally negative in getting Business buy-in for tax initiatives and things worthwhile generally got done. It does however put the onus on tax to work harder at influencing the Business.

The most interesting aspect of the tax relationship with the Business is how it impacts the Tax Function's overall performance. Research by the service industry guru David Maister into nine factors which lead to high performance in a professional services firm shows a high correlation between the financial performance and the quality of the firm's customer relationships – an observation we think is valid to extrapolate to the quality of the relationship between a Tax Function and the Business it serves.

Survey Report

Interestingly in this context, out of the nine Maister factors we asked Tax Directors to self assess their performance on, customer relationships (which Maister considers to be significantly the most important driver of performance) is not seen as being "green" by more than 55% of Tax Directors – see Exhibit 10 which shows the nine Maister factors in order of importance. This suggests that focusing on building better customer relationships with the Business offers the single biggest area of potential to greatly improve the Tax Function performance.

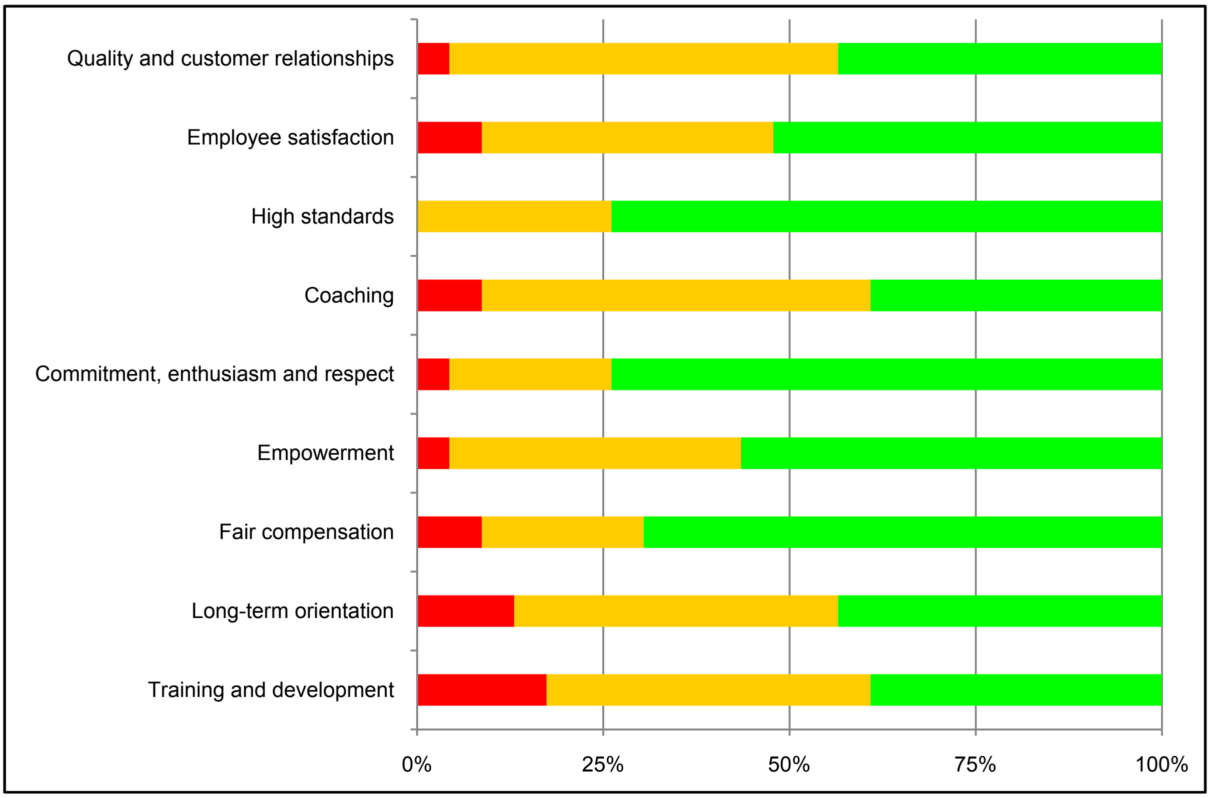


Exhibit 10: Features of high achievement

External parties, including HMRC

The relationship with external parties is the third force shaping the Tax Function's reputation.

External parties include HMRC and other Fiscal Authorities, as well as organisations used to fulfil regulatory requirements (e.g. external auditors, industry bodies, etc.). While Fiscal Authorities have traditionally been the most important external party to the Tax Function, over recent years Sarbanes-Oxley has become particularly important.

This has changed the nature of the Tax Function's relationship with auditors who, previously, also often acted as tax advisors: now their involvement is often strictly limited to audit compliance.

While Fiscal Authority relationships worldwide will be important to the groups we surveyed, it is naturally the case that their relationship with HMRC will likely be paramount.

HMRC has been changing its approach to its relationships with major UK taxpayers with the introduction of the Large Business Services Operating Model ("LBSOM") and the use of Customer Relationship Managers ("CRMs") instead of the "traditional" Tax Inspector. For some groups, particularly those in specialised industries, these changes have not greatly affected their HMRC relationship (largely because these specialised former Tax Inspectors already operated as CRMs). For others, the CRM role has been a change to the nature of the relationship.

Survey Report

Most respondents were generally positive or at least neutral about the LBSOM concept and the CRM. However, in practice, they felt the effectiveness of the initiative was hampered in three main areas:

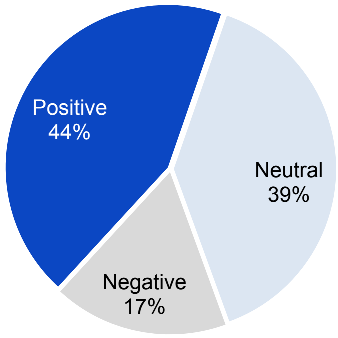


Exhibit 11: Experience of HMRC LBSOM

- the CRM was often unable to give a seamlessly co-ordinated HMRC delivery or conclude negotiations on all issues. This left the taxpayer having to continue to respond to the demands, sometimes conflicting, of other HMRC specialists;
- because of this the CRM's authority was often undermined and the lack of empowerment creates mistrust and confusion; and
- CRMs were not sufficiently skilled for the role. Particularly cited was a lack of commercial awareness and a tendency to operate according to "old" values. Exhibit 11 shows respondents assessment of the "standards of behaviour" which HMRC has stated it expects to meet.

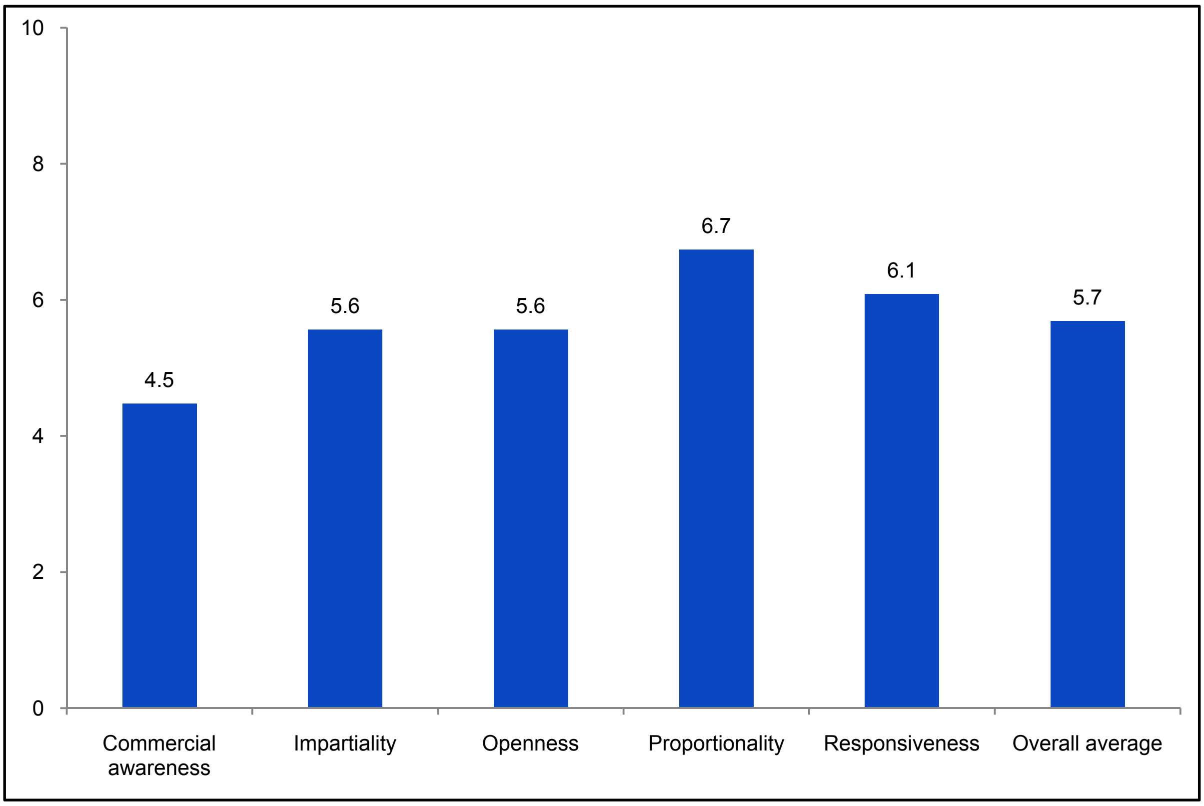
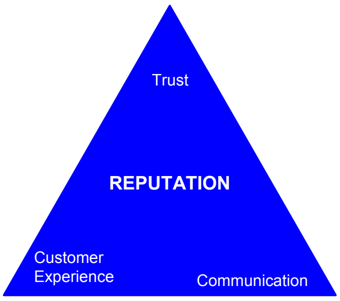


Exhibit 11: Average rating of HMRC Standards of Behaviour

Tax Directors' experiences in dealing with HMRC in its new mode have been mixed and we were left with the impression that most Tax Directors are rather disillusioned. In spite of a number of worthy initiatives such as LBSOM, Varney and Tax-in-the-Boardroom, the perceptions about the basic behaviours of HMRC staff and the nature of the relationship with HMRC has barely improved.

Survey Report



The discussion above shows Reputation governs the Tax Function's key relationships. Reputation is "the result of what you do, what you say, and what others say about you" - it is made up of a number of elements or qualities, namely: Customer Experience; Communication; and Trust. A strong inter-relationship exists between these qualities and it is difficult to separate one from the other. However, we think it is useful to look at these qualities from a temporal standpoint; particularly when trying to improve the overall reputation of the Tax Function.

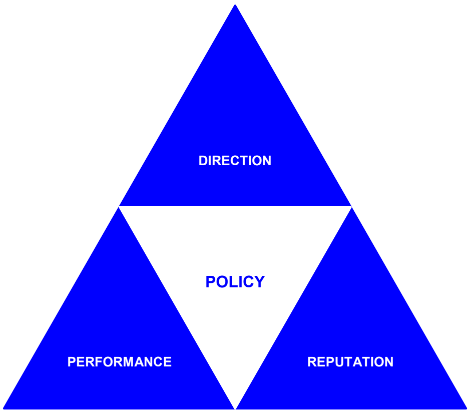
In the past, individuals have had Customer Experiences dealing with the Tax Function. Positive experiences give rise to Trust; trust that in the future the Tax Function will continue to give the right advice, fulfil its' responsibilities and provide a good Customer Experience. Customer Experience and Trust are extended through Communication; communication of the Customer Experience by customers, colleagues and members of the Tax Function. Communication is also part of the Customer Experience itself. The manner of Tax Function communication affects how advice is understood (the functional element) and how the customer feels about the whole experience (the emotional element).

The Tax Function can only attain a successful or "good" Reputation if it can achieve in all three dimensions. Without Trust, it would be difficult for the Business to go along with advice received, or HMRC to settle and agree cases. Without good Communication, the Reputation would be limited in extent, and as discussed above, the FD and the Business would not be able to deal satisfactorily with the special complex nature of Tax matters. Without a good Customer Experience, the Reputation would be negative or non-existent to start with.

AFFECTON

Conclusion

In our Introduction we characterised the Tax Function as being on a journey to become a strategic business partner. The metaphor of a journey emphasises the new ways of working; particularly greater transparency and integration with the Business. It also highlights the tension between Tax Function's specialist role and the need to integrate with mainstream Business operations. There are however limits to this analogy: the Tax Function will always be an area of acute specialism and professionalism and this must be preserved whatever pressures the Tax Function finds itself under.



Many Tax Functions have made great strides on their journey and are today strategic partners to the Businesses they serve; a paradigm shift demanded as the world moves on. In achieving this position, Tax Functions have adapted their approach and stepped up their performance in the areas of policy, direction, performance and reputation. Our Report summarises many good practices Tax Functions use to achieve this. Some of these practices may be of relevance mainly to Tax Functions of a certain size, but many others have universal potential for all Tax Functions, notably the examples of management and leadership. Leadership is always critical on a journey and is particularly relevant in facing the challenge of becoming a strategic business partner and managing a team of tax experts while achieving high levels of business integration.

The Tax Function's journey is a continuum where the destination itself keeps moving and the pace of change varies according to periods of pressure or pause in the tax and business environment. In times of rapid change and increased uncertainty (as is now occurring following the financial crisis), Tax Directors must identify the new challenges they will face and develop appropriate strategies and solutions in response. Here our Report highlights several key themes, namely:

- more formalisation, particularly in policy, processes and controls;
- greater integration of tax with the Business;
- better engagement with Business leadership;
- increased communication with an emphasis on clarity and plain language;
- value measurement and demonstrating what the Tax Function delivers;
- mainstream risk management processes;
- increased focus on staff performance;
- stronger motivation of and engagement with staff; and
- greater emphasis on leadership

Future steps on the journey – the Tax Function's commitment to continuous improvement – will require further adaption and enhancement in performance. Success will come through keeping the best of the past, the technical specialisation and professionalism, and embracing new management skills and business "nous"; achieving the right balance of policy, direction, performance and reputation. This will require continuous effort and adjustment which is the essence of good leadership and management. Hopefully, our observations and analysis will aid Tax Functions in achieving that balance.

Detailed Findings

In this section we give a detailed analysis of the responses Tax Directors gave to our individual survey questions. Some of the findings from the responses to these questions have already been considered in our Survey Report and where this is so we have not repeated these comments in the analysis below.

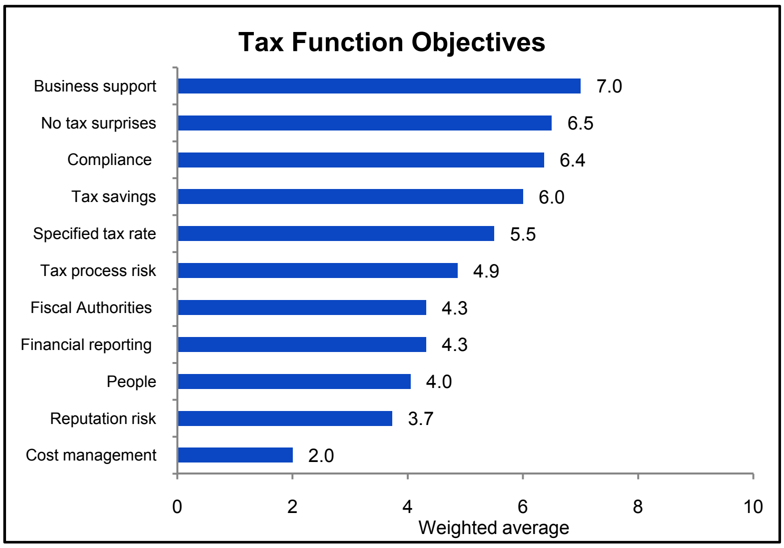
Question 1: What are the objectives of the Tax Function? Complete table.

The focus of our first question was the objectives Tax Functions seek to achieve. We were interested to understand the dynamics around these objectives – do Tax Functions have many objectives or few; are objectives well measured; which objectives are key? It was also of interest to see whether different objectives were consistently used across different Tax Functions – do Tax Functions all consider the same objectives to be important or are there objectives important to some Tax Directors but largely irrelevant to others?

In analysing the survey replies we gave Tax Directors' rankings for objectives a score or weighting: 10 for the most important objective down to 1 for the tenth most important objective. We use this weighting system to give an overview of the importance of particular objectives to the whole survey group.

All Tax Functions had a number of defined objectives. Most Tax Directors agreed that the objectives we listed applied to them and few additional objectives we had missed were mentioned.

Principal objectives



With an overall weighting of 7.0, the provision of *Business Support* was the clear leader for a Tax Function's objectives. Every Tax Director identified this as an objective for their Tax Function (the only other area unanimously identified as an objective was *Compliance*). Following Business Support, the next most important overall objectives were: *No Tax Surprises*, with an overall weighting of 6.6; *Compliance,* with a weighting of 6.4; and delivering *Tax Savings*, with a weighting of 6.0. Compared to the position for our 2002 survey, *Business Support* has become more of a priority for Tax Functions and delivering a *Specified Tax Rate* less so. Having *No Tax Surprises* continues to be important and *Managing Tax Risk* is also ranked roughly the same as before even though it has become much more formalised and probably being of greater interest to Management outside the Tax Function.

Least important objectives

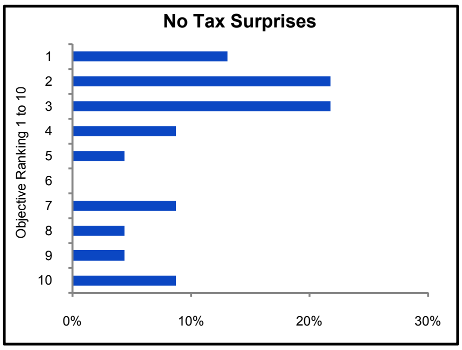
The least important objectives were given as *Tax Function Cost Management*, overall weighting 2.0; *Reputational Risk*, weighting 3.7 and, interestingly, *People*, weighting 4.0. Given that *People* are each Tax Function's main asset and the key to delivering everything the Tax Function does, we found it surprising that the *People* objective was so lowly rated. As we discuss in the Summary Report, it

Detailed Findings

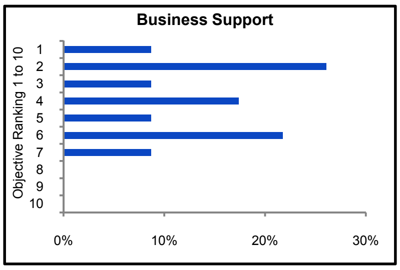
seems many Tax Directors find it difficult to get the right balance of initiatives to support the people objective given the well recognised importance of people to the Tax Function's performance.

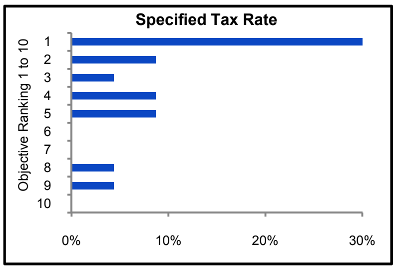
Consistency of objectives

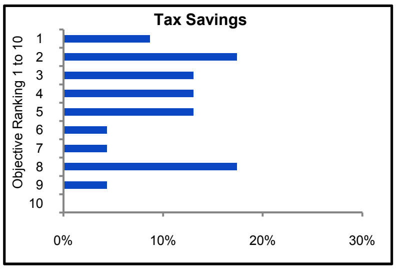
The objective most consistently rated as being important was *No Tax Surprises* with over 55% of Tax Directors putting this amongst their top three objectives. Interestingly, *No Tax Surprises* was also quite well represented in Tax Directors' three least important objectives, giving it a somewhat schizophrenic character! After *No Tax Surprises*, *Business Support* and *Specified Tax Rate* were equally the next the most highly rated objectives. A few Tax Directors put *Specified Tax Rate* in their bottom three but none put providing *Business Support* there.

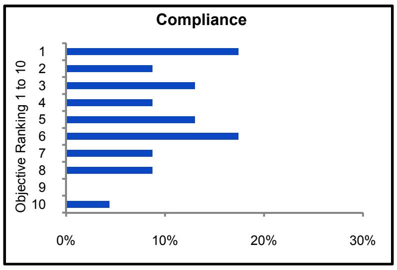


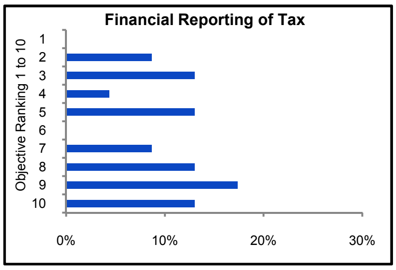
The distribution of rankings for the other objectives are:

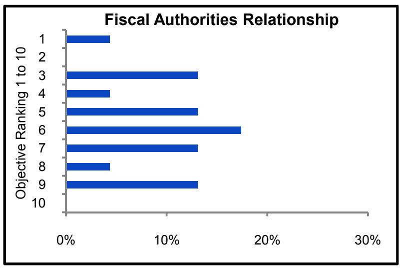


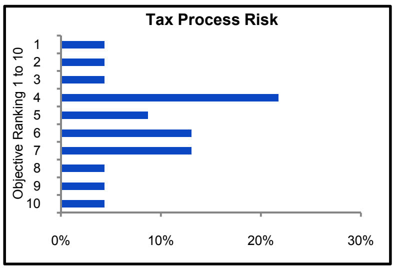


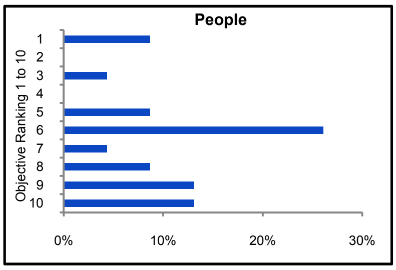


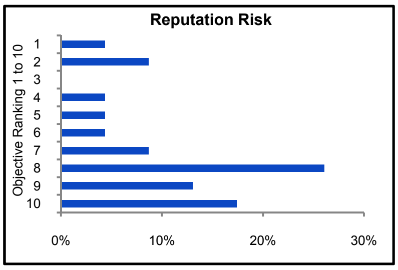






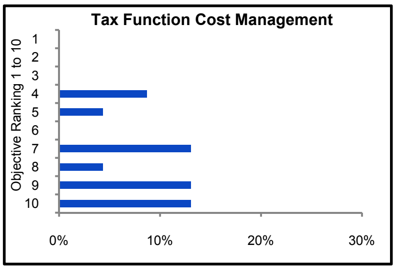






Given these times of difficult economic conditions it is, perhaps, surprising that *Tax Function Cost Management* was the bottom rated objective with no one scoring it higher than 4th.

With the gathering pace of the financial turmoil and deteriorating economic conditions happening in earnest after many of our survey interviews it may be expected that this objective will move up the priorities.



Detailed Findings

Measurement of objectives
Although a small number of Tax Functions did not measure the outcome of their objectives at all, most Tax Functions had some form of measurement for their objectives. But, typically, the performance metrics used tended to be quite informal. Thus some objectives are measured only to the extent specific issues or problems arise (for example for *Reputational Risk*) rather than being subject to a formal measurement and evaluation system.

The metrics used also often tended to be subjective (e.g. achieving *Tax Savings* needs an initial reference point against which savings achieved can be measured and defining this reference point is difficult). In this regard we found that many Tax Directors are in a position to "write their own story" about the extent to which objectives are achieved; obviously this flexibility needs to be used with care!

Overall, there was little evidence to show that objectives were being set and measured on SMART – Specific, Measurable, Achievable, Relevant and Timebound – principles.

Also, we found little consistency in approach to measuring objectives or the ways in which such measurements were made. Tax Function Cost was the most commonly measured objective, despite it being lowly rated. This probably reflects the ready availability of means of measurement for Tax Function Cost. Also, many groups applied group wide measures (for example staff satisfaction surveys) where it was often difficult to specifically pick out a result for the Tax Function itself.

Question 2: How do you see the relative importance of these objectives changing in the next five years - what is going up, what is going down and what is new?

We found no really strong and clear trend in how Tax Directors felt Tax Function objectives would develop over time and some 40% of Tax Directors saw the expectations for the Tax Function being reasonably stable so that current priorities would continue unchanged.

The trends we did see tended to be found in particular groups of Tax Functions rather than across the whole survey population. Of these more limited trends, the growing importance of *Fiscal Authority Relationships* was the strongest. Here, about 20% of Tax Directors sensed a growing importance (but, also, with some seeing a reduction in importance). The driver here seemed to be specific to industries feeling more exposed to government drives towards a higher tax take.

With the prominence of Sarbanes-Oxley over the past few year (for SEC Registrants directly and the general impetus it has created through the rest of the market), many Tax Directors felt it was time for a reduction in focus on *Tax Risk Management* on the basis that this has now been "done". Other Tax Directors saw *Tax Risk Management* still firmly on the agenda, becoming a feature that has simply stabilised into a standard "business as usual" matter that won't be going away.

Increasingly, this appears to be a good call and it will be interesting to see what impact the Budget's BN 62 announcement will have as "Senior Accounting Officers" find themselves personally liable for the adequacy of their tax reporting systems. The continuing relevance of risk and process issues was echoed by many Tax Directors mentioning that they saw increasing demands in respect of robust processes and other "licence to operate" issues, for example VAT and transfer pricing compliance.

The growing pressures on tax avoidance, and as the disclosure regime starts to bite, led some Tax Directors to suggest that emphasis on the importance and achievement of *Tax Savings* was likely to

Detailed Findings

reduce in order to better balance their group's tax planning against tax risk. Other Tax Directors felt that these effects may have passed their peak and that there could be a return to somewhat more aggressive planning. Clearly where a group stands on this spectrum will reflect its past appetite and experience for aggressive planning and its competitive position.

A commonly articulated area of increased emphasis going forward is *People* – "they are the future" said one Tax Director. Given its current lowly rating, moving the *People* objective up the agenda seems a natural initiative for many Tax Functions: with growing cost pressures and tighter budgets it will be essential to get the best possible result out of, and for, the tax team.

Question 3: Does your organisation have a tax policy (a set of principles governing the conduct of the Tax Function)? If yes, how are these principles put into practice?

The large majority of groups, certainly many more than in our 2002 survey, now have a Tax Policy – less than 10% did not and some of these felt their company code of conduct adequately covered how Tax Function staff should work. We believe this increase has been driven by factors such as the Henderson Report, HMRC's "Tax in the Boardroom" initiative and, most importantly, Sarbanes-Oxley.

Our discussions indicated that about half of Tax Directors were able to use tax policy development as a means of engendering a strategic dialog about the group's tax scope and operations with the Board or Audit Committee. This usually resulted in formal Board approval and endorsement of the final tax policy. Some Tax Functions also actively develop their tax policy by discussion within the tax team so that the policy development process offered an opportunity and effective tool to build team-level understanding and consensus.

It was often the larger Tax Functions that had formalised approaches to their tax policy development and in monitoring adherence; smaller Tax Functions would usually have shorter management chains able to disseminate an understanding of what is expected of the Tax Function without too much procedural overhead.

This spectrum of approach leads to policies with varying degrees of sophistication; some tax policies being very informal, others being well documented and comprehensive:

- segmented by group-wide then country level issues;
- giving principles of expected behaviour, standards of integrity and Tax Function goals;
- setting out standards for how the Tax Function should treat its people;
- describing the Tax Function's activities, processes, controls risk management arrangements, and standards of disclosure.

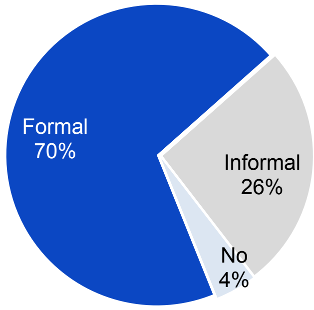
Groups also varied in how they exploited their tax policy. Some groups disclose their tax policy quite widely, even externally, and engage with the Business in measuring the extent of compliance with policy.

We found interesting examples of Tax Functions using their tax policy as the basis for building an internal "tax brand" with the tax policy being used as a kernel around which to foster tax team spirit and cohesiveness which is then presented to the rest of the Business. In these cases the policy was of such importance that it is also used as a key component of the annual performance dialog for the

Detailed Findings

tax team. In other groups the tax policy was a more static tool, relatively anodyne in its content, created more for form's sake rather than being used as real guidance.

Question 4 & 5: Do you have a formal or informal tax strategy? If formal, which of the following elements does your strategy include?



The vast majority (over 70%) of Tax Functions had a formal documented tax strategy and, as was the case in Tax Functions' use of tax policies, there was a range of approach in the use of tax strategy. Of the rest, a further 26% had an informal strategy with only 4% having no strategy. This compares with our 2002 survey when 32% of those surveyed had no tax strategy.

Most (just under 50%) of tax strategy documents:

- gave a description of the Tax Function's roles, responsibilities and accountabilities;
- identified the Tax Function's objectives and the measurements to be used to judge performance;
- gave a plan or approach to the delivery of objectives; and
- set out a risk framework within which the Tax Function was to operate.

Several respondents to our survey combine their tax policy and tax strategy in a single document and some tax strategies are also incorporated in a wider group strategy document. This latter approach was adopted particularly where the Tax Function considers itself to be "part of the business" rather than simply a function "that looks after tax". Tax Directors wishing to promote the integration of their Tax Function into the Business might consider this approach as an opportunity to build strategic links.

Some Tax Function's used their tax strategy as a sophisticated tool, refreshed each year, to document objectives agreed with the Finance Director/Board and to provide a process of delegation to set annual objectives for each team member for subsequent quarterly review.

Question 6: How is your strategy developed and communicated to:

- **Tax function personnel;**
- **Wider business and finance personnel;**
- **FD and/or Board;**
- **Externally (Fiscal authorities, professional firms, shareholders, analysts).**

Strategy development
We found tax strategies being developed in a number of ways:

- a top down approach using a small central team to develop strategy, often then subsequently "stress tested" by discussion with the Finance Director/Board or external advisers;
- a bottom up approach with extensive involvement from the wider tax team;
- discrete development in annual exercises; and
- more evolutionary development in frequent (say, quarterly and sometimes weekly) meetings.

Detailed Findings

This variation in approach frequently reflects how Tax Functions use their tax strategy: some want a high level strategic document which, by its nature, does not need frequent revision to its primary thrust; others use their tax strategy more tactically as a tool to control individual objectives and daily workflows. The latter approach naturally necessitates a programme of much more regular updating.

Dissemination
Critical to the tax strategy's effectiveness is how it is disseminated and its communication inside the Tax Function and to other stakeholders. How this achieved is normally driven by the tax team's size and geographical distribution. Tax Directors with larger teams found web casts and telephone conferences, supported by regular e-mail, valuable as a way of fertilising debate at local tax team level. Other groups disseminated their strategy using "strategy meetings" of senior team members, held several times a year, followed up with local team meetings to complete the cascade process. Smaller tax teams often built strategy dissemination into their normal tax team meetings.

We found the extent of tax strategy dissemination outside the Tax Function much patchier. Some Tax Directors shared their tax strategy with their finance community through presentations at Finance Conferences or the circulation of strategy documents; exposure of tax strategy to the Business was even more ad hoc.

As yet there is little exposure of tax strategy to external parties, although some Tax Directors did discuss it with external advisers and a few shared it with Fiscal Authorities (sometimes subsumed into generic presentations about corporate governance/assurance). A small number of Tax Directors see the exposure of their tax strategies to Fiscal Authorities as an area where there might be a growing pressure and demand.

In our discussions with Tax Directors about tax strategy we found a number of practices that we thought particularly effective. These are included in the Summary Report.

Question 7: In optimising the Group's tax position, what is the split between:

- **tax efficient financing initiatives; and**
- **business/tax alignment initiatives**

65% of Tax Directors told us most of their current tax planning is mainly based on tax efficient structuring and financing initiatives ("boxes" tax planning it might be called) compared to business/tax alignment solutions (with 10% of groups using a boxes approach entirely).

The preference for boxes planning partly reflects commercial restrictions. Those groups having third parties in their supply chains (for example joint venture operations) or little intra-group trading or tax attributes stuck in high tax countries are generally limited in optimising the distribution of their profits and, as a result, tend to use boxes tax planning. While this natural advantage for boxes tax planning will remain we found a trend in tax planning towards more business/tax alignment initiatives: projected to become 50%:50%. Thus, 65% of Tax Directors believed they would be doing more business/tax alignment initiatives in future compared with 15% who thought they would be doing less and 25% who saw the balance of their planning remaining unchanged.

Tax Directors moving towards business/tax alignment initiatives primarily explained this trend as one of defensive positioning (believing that boxes planning sometimes may be more susceptible to

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counteraction by Fiscal Authority or they were already experiencing high levels of Fiscal Authority attack). Several Tax Directors mentioned they already had a confirmed position of not participating in "packaged tax planning ideas". Another reason given was that it may be possible to be more systematic in approaching business/tax alignment initiatives and this would expand the use of such opportunities.

Question 8: Is there anything that you find particularly useful in presenting tax information/issues to the Finance Director or Business heads?

Tax Directors told us the key message here was to make sure communications are suited to the intended audience – speak their language and not yours. Some of the suggestions offered were:

- keep messages short and simple;
- don't try and teach the audience tax – or at least only the tax they really <u>have</u> to understand;
- focus on what the audience really needs to know: what the risks are, how will they be controlled, how they will be reported;
- put the issues in the business context first (also emphasises the Tax Function partnering with the Business) and keep the tax context for second;
- bring the tax issues to life by using numbers effectively (the audience in most tax presentations will be numerically literate). This also helps to keep the issue specific and avoids talking in generalities. Valuable landmarks might be: how much tax is actually paid; particular jurisdictions with high effective tax rates; putting tax outcomes in business metrics (how much would sales have to go up to create the same post tax result); net present value cash flows on projects to show the tax benefits and highlight the difference in NPV with and without planning;
- state conclusions and considerations (commercial and political); and
- "know your audience" – what buttons do you need to push with each individual? Is the Finance Director a details or concepts man? If he is a details man he won't be happy until you provide him with the old fashioned pile of detailed papers to thumb through; if details aren't his forte be careful to strike the right balance with his attention span so key messages are conveyed in the limited time available.

Allied with the ways mentioned above of presenting tax issues, the careful use of influencing initiatives outside formal presentations was identified as being of value. Preceding key meetings with a programme of networking and word of mouth is a powerful way of creating the right level of understanding in the various constituency audiences – particularly in those situations where getting enough formal airtime is a challenge.

It also gives the opportunity to gather feedback so that otherwise unthought-of of issues can be anticipated and dealt with by flexing the presentation; building in additional influencing, if required; or recruiting other supporters to help shape opinions. When dealing with particularly new initiatives Tax Directors also suggested trying to involve people (from the Business, or possibly externally) with first-hand experience of the idea. For example, if you are seeking to implement a tax effective supply chain initiative and someone in the Business has already been through a similar project implementation, they will likely be better able to build business support for the initiative than you can yourself. A similar approach is to draw on what competitors have done: benchmark tax rates or identify the effect of planning on the effective tax rate or cash tax rate.

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Question 9: Which is more important:

- **Pre-tax/post-tax;**
- **Finance Director/Business?**

In 43% of cases Tax Directors told us they believed the Finance Director was driven by pre-tax metrics and considerations – a figure we thought surprisingly high, especially since earnings per share is a post tax measure. For the business leaders Tax Directors thought 87% worked on a pre-tax basis: the Business is, predictably, pre-tax driven.

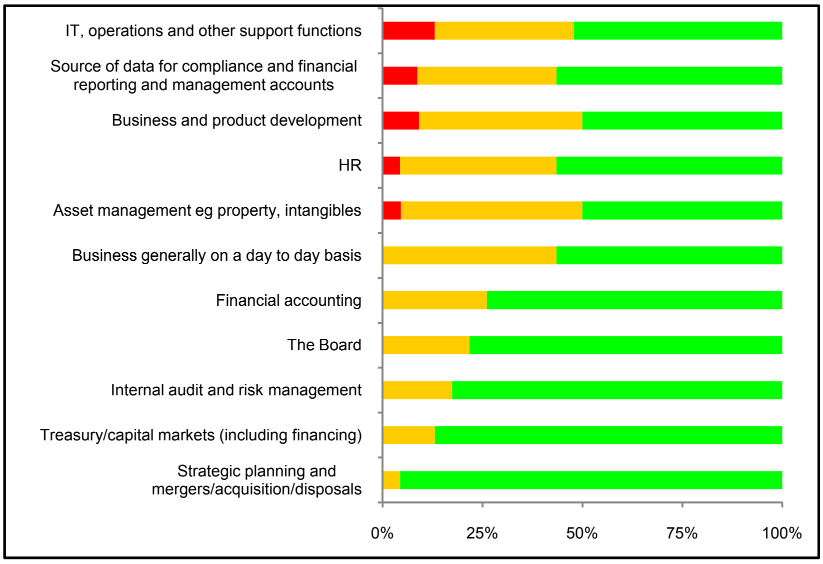
Question 10: How do you perceive pre-tax and post-tax measures affect the support the Business gives the Tax Function?

Just under 45% of Tax Directors felt their group's use of pre-tax performance metrics created an impediment to getting tax ideas implemented, although the really important tax initiatives got done anyway. Despite this significant minority, most Tax Directors did find the Business supportive, recognising a need to be good corporate citizens in supporting the Tax Function's needs.

The difficulty in getting suitable business support reinforces Tax Directors' need for good influencing skills and being savvy in pitching tax initiatives. This is particularly so in groups where management reward comes in the form of cash bonuses based on pre-tax results (indirect tax and employment tax planning being an exception since this tends to impact the pre-tax figures). Where management reward is given through share based schemes Tax Directors found they could make their life easier if they emphasised the EPS benefits their tax planning might deliver.

Tax Directors also said it was easier to get business support for tax initiatives, particularly meeting compliance and reporting requirements in those groups that had a culture of strong central financial control and where the Finance Director was interested in tax.

Question 11: Rate the Tax Function's relationship with the following. Consider nature, frequency and timeliness of interaction, in the context of what is important to tax. Consider interaction not just at senior levels. (Red/amber/green: red is unsatisfactory and green is excellent)



The Tax Function's most important relationships are probably those with the *Board* and then that with the *Business.*

We did not find any Tax Directors who thought either of these relationships was "red". However, just over 40% of Tax Directors thought their relationship with the *Business* was "amber" and almost a quarter thought the relationship with the *Board* was this colour – see table.

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Since providing *Business Support* is the objective Tax Functions believe to be most important, the relatively poor state of Tax Functions' relationships with the *Business* is clearly a concern and identifies an area in need of remedial action. We believe that this current state of affairs reflects the ongoing learning experience that Tax Functions have embarked on in framing how they should engage with the Business. It also shows the need to press on with this journey. This is echoed by many Tax Directors telling us that they found it difficult to decide which areas of the Business they should target and how to structure that engagement without spending too much time on low value-added activities. This was coupled with an uncertainty about "unknown unknowns" – how do you know what you don't know and, if you aren't close to the Business to start with, how do you build sufficient credibility to get into the Business's planning early enough to add and evidence value. Another reflection of Tax Functions' uneven business relationship is in *business and product development* – an area requiring a lot of effort to get influence up front. Here only 50% of Tax Directors felt the relationship was green, while 10% felt it was as bad as "red".

On a more positive note, the relationships Tax Functions have with the *strategic planning* and *mergers & acquisitions* functions was very positive, as was the relationship with *treasury/capital markets.* This is unsurprising as tax will be widely seen as a key player in these arenas therefore the "turf wars" should be few. It also suggests a possible opportunity for Tax Functions to build on these good relationships and to drive them into the "normal" business – perhaps using the tax aspects of post acquisition implementations as a tool to effect this bridge. Relationships were also good with *internal audit/risk management* (with just under 85% of Tax Directors saying the relationship was green) and *financial accounting* (75% green).

The most problematic relationship area tax had with other specialist functions was that with *IT, operations and other support functions.* This may reflect these functions' primary focus being business support, with the Tax Function being a relatively low level "customer" (albeit probably with relatively few critical requirements). It is also the case that where the Tax Function does have needs (e.g. in IT) these may be quite specialised and beyond that support function's immediate knowledge. Another relationship needing boosting is the *sourcing of data for compliance and financial reporting* (where just fewer than 10% of Tax Directors said it was red, and 35% amber). Since Tax Directors say compliance is one of their top three objectives this must be another critical relationship for the Tax Function and, with only 55% of Tax Directors having a green relationship, it suggests another area for remedial attention.

Question 12: How has the Large Business Services Operating Model, and in particular the Customer Relationship Manager changed your Group's relationship with HMRC?

Overall impressions

We found Tax Directors were generally in favour, 42%, or at least neutral, 39%, about HMRC's Large Business Services Operating Model ("LBSOM"). A factor significantly affecting this impression is the calibre of the CRM. The bright, energetic and enthusiastic CRMs make the working experience far more satisfying so that bringing outstanding issues to a successful resolution is more straightforward. Despite this generally positive outlook, comments about the CRM role lacking clarity and empowerment were common. Here it was felt other HMRC specialists continued to act without reference to the CRM so the CRM was prevented from effectively managing HMRC's focus. Other apparent teething troubles were where CRMs came and went in quick succession (some lasting only a few days).

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For some Tax Directors, therefore, the jury is still out on the new arrangements the LBSOM implies and more time is needed for them to bed down and prove their worth.

HMRC Behaviours

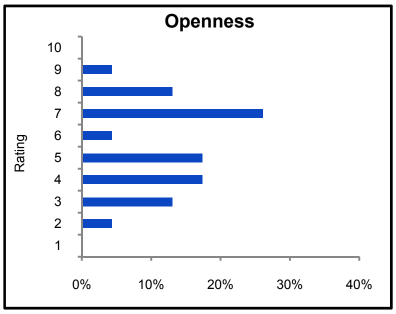
The OECD's Forum on Tax Administration's held its Cape Town meeting during 2008 and announced the results of its study into the role of tax intermediaries. This was initiated at the 2006 FTA meeting in Seoul and was then broadened into a wider review of the tripartite relationship between Fiscal Authorities, taxpayers and tax intermediaries. The study, led by HMRC, suggested Fiscal Authorities could create more efficient and effective relationships with taxpayers and tax intermediaries by using a framework based on behaviours of *commercial awareness; impartiality; openness; responsiveness;* and *proportionality.*

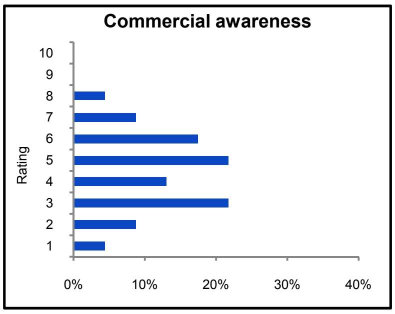
We thought it would be interesting to ask Tax Directors about their impressions of these behaviours in their own relationship with HMRC.

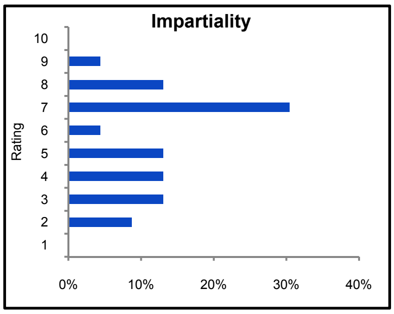
The overall results for the quality of these behaviours was (out of ten with higher scores being better):

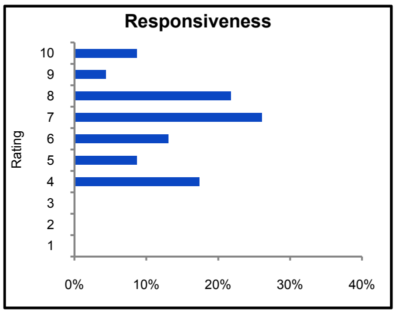
- *commercial awareness* 4.5;
- *impartiality* 5.6;
- *openness* 5.6;
- *responsiveness* 6.7; and
- *proportionality* 6.1.

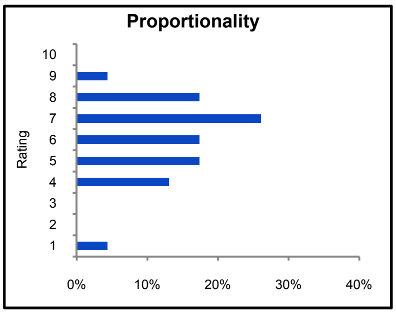
Naturally, Tax Directors' opinions varied about the extent these attributes appeared in their relationship with HMRC. This distribution is shown below. We also show the distribution of what might be called the overall strength of the "taxpayer relationship" between HMRC and individual Tax Functions. We have given a measure to this relationship of the average score each Tax Director gave for the five HMRC behaviours.

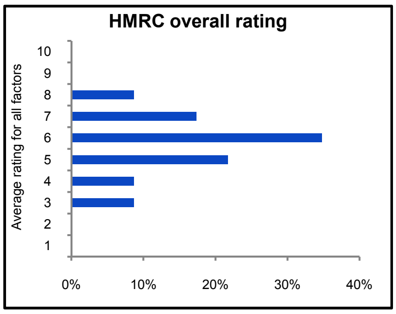












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HMRC's best score was for *responsiveness,* which was the only category where Tax Directors gave HMRC full marks (14% of Tax Directors giving a 9 or 10). Following responsiveness, the next best score was *proportionality* and then *openness* and *impartiality* together. Interestingly, the scores for *openness* and *impartiality* seem to show a bimodal distribution suggesting two groups of Tax Directors, one having a much better perspective of HMRC's performance than the other.

Least favourably scored was *commercial awareness* and the scoring for this behaviour was more consistent than for *openness* and *impartiality*. This suggests a relatively broad feeling among Tax Directors that the development of better *commercial awareness* amongst its CRMs should be an area of focus for HMRC.

Question 13: As a leader, what do you believe is most important in successfully managing the Tax Function?

An interesting challenge when, as one Tax Director put it, "hardly anyone knows what you do".

In that light, the most frequently identified requirement was *communication* – mentioned by just over 60% of Tax Directors. This need for good communications happens at several levels:

- within the Tax Function. The need to set objectives and communicate a clear vision for the tax team to give a shared sense of direction and travel. The vision needs consistent articulation so goals are reinforced and not subsumed by "initiative overload" and that the team always knows what's expected of them;
- within the wider Finance community and with the Board to create a strong and effective relationship between the Tax Function, the Finance Director and the Board; and
- with the Business. The Tax Director has a key role in facilitating communication and bringing alignment between the Tax Function and the Business. This is done by opening effective channels of communication so the Tax Function can clearly understand the Business's aspirations and objectives and the Business knows how to access effective and timely advice from the Tax Function.

The next most frequently mentioned challenge was *people*:

- getting the quality right;
- getting the right people in the right position;
- empowering the team with the right levels of responsibility;
- building a team that is strong, effective and cohesive;
- setting the right objectives;
- having a team committed to continuous improvement; and
- setting the right remuneration to keep the best people.

No other factors were consistently or frequently mentioned.

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Question 14: What are your top three challenges in leading the Tax Function?

Echoing the replies for Question 13, the challenges most strongly stated by Tax Directors are *people* and *profile/interaction* (i.e. communication), with the *Business* (each mentioned by just over 55% of Tax Directors) coming next, followed by *managing tax complexity* (30%).

Points made under the *people* heading included:

- getting them – a competitive tax marketplace in London with more limited supplies of good quality staff outside London;
- keeping them: motivation and managing expectations;
- developing them: finding work of sufficient scope and variety to stretch good staff; and
- creating a good career path (particularly in smaller Tax Functions) and managing career aspirations.

Points made under the *profile/interaction* with the Business heading included:

- not knowing enough about what is going on in the Business;
- getting the right level of interaction: setting the balance between freezing business decisions until the Tax Function has kicked the tyres and the Business doing things without any Tax Function involvement;
- overcoming the inertia that stops the Tax Function getting out into the Business to find out what's going on;
- getting the right business support in the right place;
- communicating and demonstrating the value of tax; and
- taking tax out of the "too hard to understand" basket and framing communications that the Business can understand.

Under the *increasing tax environment complexity* heading, points included;

- keeping up with the pace, volume and volatility of change in legislation;
- dealing with increasing fiscal authority aggression and litigation;
- setting the right priorities to balance volume of work against pressure to deliver; and
- working across different jurisdictions. Culture diversity and varying ways of working make it easy for unidentified assumptions to exist and remain untested and to misunderstand technical issues in different places.

Tax function cost pressures was not a frequently mentioned issue (fewer than 5% of Tax Directors raised this as a concern). Probably this will be moving up Tax Function agendas!

Question 15: What do you see as different about leadership in a tax department compared to anywhere else in the Business?

25% of Tax Directors felt there was no real difference. In other words, you are a senior manager in the company and you are expected to use ordinary business approaches and share the group's vision in the same way as your business colleagues.

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Others felt the Tax Function's specialist nature did create a difference:

- the Business often sees tax as a "black box" where there are clear cut answers that the Tax Function is expected to know immediately;
- this brings isolation and a siloed existence – getting the tax team to see the business issues allied with the Business being happy not to understand tax;
- the possible disproportionate effect tax decisions can have;
- tax's specialist nature brings difficulty with career paths (staff can't readily move or dip in and out of other parts of the business). Also, there is competition with the profession in providing the "big career" with the Business having no equivalent career competitor;
- an absence of a grounding or tradition of tax people in general management. There are few generalists in the Tax Function and tax specialists generally don't fit into a regimented managerial structure; and
- the differences may be large in making comparisons with the Business but are less acute when making comparisons with other finance people and functions.

Some Tax Directors found the difference with the Business made their life easier: tax teams tend to be more stable; they have a greater level of familiarity with the issues they face; and a clarity of objectives. Also, the similar background that most specialist tax staff are drawn from makes it easier to lead them as a single tax team.

Question 16:
a) In your view what is the right amount of tax that an organisation should pay?

Most Tax Directors felt the right amount of tax is that given by the letter of the law. However, it is fair to say that this position is shaped by a variety of factors. For example, where the Business has a special relationship with government – perhaps because government is an important business partner or the Business is particularly important to a country's economy – a "spirit of the law" approach may be seen to have commercial benefits that can well outweigh the benefit of exploiting aggressive tax opportunities. It was also the case that Tax Functions will actively vary their position from one jurisdiction to the next.

b) How do you manage risk where there is ambiguity?

Points mentioned include:

- get the right data;
- assess the position from different points of view. Talk: internally and externally to get the right advice (including asking the Fiscal Authority);
- get Counsel's opinion;
- use an integrated risk model predicting financial implications based on probability and impact;
- file quite aggressively (but with high payments made to protect penalty position) to create a portfolio of issues to negotiate;
- expect to challenge and be challenged;
- provide conservatively and priorities provisions to be managed in a staged process;

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- escalate issues to get sign off at the right level for material risks; and
- ensure the Board and Business understand the risks.

c) How is this understood by the tax team?

Tax Directors felt that the risk management issues were generally well understood, driven not by particular techniques but simply lots of communication and a focus on good team work. Larger Tax Functions tended to have more formal processes for embedding this understanding, for example a cascaded approach of quarterly sign-offs on risks and provisions.

Question 17: In managing the Tax Function, what are the key performance indicators that you focus on? How is the information collected and summarised for these measures?

We found no single clear key performance indicator that is consistently followed by all Tax Functions and, consequently, there is considerable variation in the key performance indicators individual Tax Functions use. Most key performance indicators did not seem to be part of a very formal system and some Tax Functions had no key performance indicators at all.

The key performance indicators we found focussed around three or four main areas:

- monitoring or predicting the tax rate – cash or effective (used by around 45% of Tax Functions);
- monitoring compliance statistics, for example timelines and the proportion of computations filed by given milestones (used by just under 50% of Tax Functions);
- scorecards or a formal process to monitor performance against set objectives (present in around 25% of Tax Functions); and
- monitoring penalty and tax audit experience or other measures of "tax surprises" (used by around 20% of Tax Functions).

Some Tax Functions tracked their performance using formal processes seeking to produce an objective balance scorecard. Such processes were sometimes run by a distinct "Programme Office" that also had oversight of the implementation of tax initiatives.

Tax functions also report tax savings – often measured in NPV terms. We found the systems used to create these reports were frequently quite subjective: it's difficult to identify a real "base case" tax cost against which the tax savings created can be measured and sometimes savings were be recorded more than once or in several years.

Question 18: What do you find particularly useful in developing and implementing tax ideas?

Communication seems to be the order of the day here and Tax Directors mentioned a variety of useful formats to structure their communications:

- discussions and planning in conjunction with the Business (or business sub-sets such as business units or geographic regions) were frequently mentioned. These have the objective of building and developing a deep understanding of the Business's needs in order to catalyse ideas;

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- also frequently mentioned were tax team brainstorming sessions and peer reviews. Again, these catalyse ideas and make sure that the maximum use is made of ideas that are already tried and tested; and
- networking with advisors, both to brief advisors on current trends and initiatives in the Business and to pick up on current ideas in the market place. Tax Directors mentioned that there was previously a greater level of reliance on the Big 4 for pre-packaged planning ideas. This emphasis seemed to be waning somewhat, being replaced with ideas generated, with tax advisors, through a greater understanding of the Business.

The various discussions mentioned above often happen as periodic “strategy days” or interdisciplinary meetings. Making these happen on a regular basis helps to generate a creative tension amongst the participants as they know they will be expected to come up with fresh initiatives and proposals for the next meeting.

Interestingly, one forum for the generation of ideas that seemed to be relatively unused was networking with other Tax Directors or Tax Functions. This was certainly only clearly apparent in specialised industry sectors and did not seem to extend more generally.

Question 19: What do you find particularly useful in influencing the Business to achieve tax compliance and planning objectives?

An interesting message here, particularly in relation to delivering better tax compliance, was that the need to deliver more formalised and controlled business processes (often with external drivers, such as risk management and Sarbanes-Oxley) has obliged Tax Functions and the Business to talk to each other and co-operate more because both have parts to play in defining the final outcome. A number of Tax Functions found this has empowered them and given them a stronger voice in influencing the Business.

Tax functions should therefore regard strong processes as a valuable enabler for engaging with the Business and a stepping stone in building stronger relationships able to deliver benefits on the planning front as well as better compliance. The Tax Function should therefore try and encourage cultures within their organisation that support strong processes and Tax Directors mentioned they have found benefit in there being:

- a strong centralised financial management ethos;
- strong and clear accountabilities; and
- a need to build engagement with other parties who also rely on strong processes, for example the Financial Controller function.

Other factors Tax Directors mentioned as important are quality communication / networking / getting out and about – the bedrock of creating a strong influencing power.

In building a class act here, several Tax Directors mentioned the need for consistency and persistence – creating the right power base for the Tax Function takes time.

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Question 20: How would you describe the Tax Function's ability to complete computations, manage correspondence and deal with Fiscal Authorities' issues on a timely basis? (Red/amber/green: red is often behind and green is totally under control.)

No "reds"; although one third of Tax Directors thought this was "amber" for their Tax Function.

Question 21: What are the major factors that contribute to this outcome?

The causes Tax Directors mentioned for problems in this area were:

- poor use of technology – a reliance on flaky spreadsheets / too much manual processing, rather than using robust tax software;
- information overload / poor quality data; and
- being bogged down in the past – too many old issues still open with Fiscal Authorities.

Success was attributed to:

- good processes (some Tax Functions said they had been able to move from "red" to "green" because of Sarbanes-Oxley driven process improvements), with well defined requirements, good technology, good data flows (right accounts coding and agreed and defined "right first time" data coming out of the finance function); and
- getting the right resource in place with clear division and definition of roles and responsibilities.

Question 22: How does the Tax Function allocate its time between the following areas?

	Actual	Ideal
Administration and management	7%	6%
Planning, projects, research and innovation	20%	23%
Tax advice to Business including influencing	15%	17%
Compliance including Fiscal Authority audits	36%	30%
Reporting and risk management including Sarbanes-Oxley	12%	13%
Lobbying and industry bodies	4%	4%
Training, staff development and coaching	6%	7%
Total	100%	100%

There was a surprisingly good match between the actual time allocation Tax Directors said their Tax Functions currently spent on activities and their ideal time allocation. Naturally, Tax Directors wanted to spend less time on compliance and more time innovating and planning and advising the Business, but really the differences between the actual and ideal were small.

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Question 23: How has the Tax Function budget changed in real terms over the last three years?

Tax Directors told us that their budgets had moved as follows over the past three years:

- significantly increased 52%
- increased ≤ 10% 22%;
- unchanged 22%; and
- decreased ≤ 10% 4%.

To us this suggested Tax Functions are starting to get the recognition they need – as the organisation starts to understand the value tax can deliver it is willing to fund it better. Also, the Tax Function's needs for better systems and management have driven additional funding. It will be interesting to see if these budget gains can be sustained over the next few years as budgets will likely be more tested.

Question 24: How are the costs of the Tax Function recovered?

Tax Directors told us their functions recover their costs as follows:

- allocation based on predetermined usage 46%;
- direct charge to business customers on actual usage 6%; and
- no charge or allocation 49%.

Note: the category of no charge or allocation includes costs recoveries made as part of the general corporate overhead allocation.

Few Tax Functions seek to charge their services out like an in-house professional services firm, although often they have a very similar role.

Question 25: For which tax areas is the Tax Function responsible?

All Tax Directors told us that their Tax Function was responsible for corporate compliance and planning in the UK, but 20% of Tax Functions were not responsible for tax compliance internationally.

The principal areas which Tax Functions were not responsible for was employment tax planning and compliance; about a third of Tax Functions not being responsible for planning and almost 60% not responsible for compliance. Other major areas which Tax Functions were not responsible for were transactional taxes such as stamp duty and customs duties and, to a lesser extent, VAT compliance (where about 30% Tax Functions were not responsible).

Question 26: How many full time equivalent professional tax staff are there in the Group?

Average Tax Function size in the UK is a staff of 35, with a further 80 staff outside the UK. This average is significantly influenced by a few large Tax Functions. The average size of the biggest five Tax Functions we met is 105 in the UK and, if these Tax Functions are excluded, the average UK staff size for the rest drops to 14.

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It should also be noted that these numbers may well not reflect all the people doing "tax" jobs since some groups have staff outside their formal tax department who perform tax activities which other groups would include inside their Tax Function.

Question 27: How many department heads are there in the Tax Function that report directly to you?

Question 28: Size of team (number of professional staff)

The internal structure of the Tax Functions in different groups was very diverse and no meaningful data was identified for these questions.

Question 29: How do you manage the diverse range of tax activities and functions especially where small offices are located overseas?

Generally Tax Functions were organised on a regional basis and communications maintained using periodic conference calls or visiting for face-to-face discussions.

Question 30: How do you organise the Tax Function in terms of a central tax group versus tax professionals located within a business unit? In your experience, what are the main factors that influence location of tax staff?

An evolutionary process seems to exist here. Small Tax Functions have to start as a single centralised group: tax people need a tax community in order to function effectively and to create and preserve a "tax" culture. However, as the Tax Function grows in size other options become possible. For example, small tax teams can be embedded in businesses away from the central Tax Function and this is an ideal many Tax Directors would like to follow, since it brings stronger business ties. This strategy also, however, brings a tension requiring management in terms of Tax Function cohesion and making sure embedded teams don't "drift off" or "go native". Tax Directors told us the approach of embedding small tax teams into the Business tends to be particularly useful where a compliance activity requiring a close relationship between tax and the Business exists or where the business unit has some special character (in terms of location or function).

The organisation of Tax Functions between centralised versus decentralised units closer to Business, is one of several dilemmas Tax Directors have to resolve. A similar dilemma arises in respect to the degree of tax specialisation within a Tax Function. Another is the geographic versus business alignment and accountability.

Question 31: How do you organise the Group's tax responsibilities across different businesses, countries and types of tax?

Principally, responsibilities are organised geographically – tax planning has to end up in tax compliance filed with national governments.

Question 32: If there is a conflict, or something goes wrong, who is ultimately responsible for it?

Tax Directors told us that they were mainly responsible, although in a small proportion of groups it was the local Finance Director.

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Question 33: How has the Tax Function changed in the past five years and how do you see it changing in the next five years in terms of:

- **number of people;**
- **the organisation of the function; and**
- **the processes used.**

The Tax Directors' responses here were diverse, often reflecting trends driven by the Tax Function's specific history and the drivers affecting each business. Apparent trends were more:

- functional specialisation;
- in-country staff; and
- technology, process standardisation, automation and electronic data capture.

Question 34: How would you rate the sufficiency of resourcing of the Tax Function? (Red/amber/green: red is severely under resourced and green is fully resourced)

Tax directors told us there were no "reds"; however, just over 50% of Tax Directors believed the position was "amber"; a figure that we thought was quite high.

Question 35: How are the skills and competencies in the Tax Function matched to the work requirements of the Tax Function? (Red/amber/green: red is poor match and green is perfect)

Again, Tax directors told us there were no "reds" and this time just over 40% believed the position was "amber", a figure that we also thought was quite high.

Question 36: What are the main factors affecting this?

Tax Directors told us the ambers were caused by:

- high business growth giving the Tax Function difficulties in keeping up;
- shortage of available 3-5 year post qualification candidates; and
- specific skill shortages e.g. deferred tax accounting capabilities.

Given the importance of people in earlier questions these high numbers of amber may not be surprising.

One must suspect that the credit crisis will spark various cost reduction programmes which will put the sufficiency of Tax Function resources under further pressure. How will this work out in practice? The inevitable truth is that cuts are likely to be overdone and in a couple of years time (and at the same time as governments expect to be able to recoup current tax incentive measures) Tax Functions will find themselves under resourced.

A counteracting feature might be that the professional firms will also be shedding jobs which should put fresh blood into industry job markets allowing Tax Functions access to new high quality hires.

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Question 37: How many days formal structured training and development do professional staff receive average per annum and what is the budget per head?

As usual, we saw a lot of variation. Most Tax Functions provide about five days a year of training (with some Tax Functions giving up to ten). Of this training load, about half is management training.

Budgets per head, where set, were in the order of £1,000-£1,500, although many Tax Directors believe that training is not especially budget constrained. Many Tax Functions leave training needs to individual discretion; others often use professional firms to provide short seminar style training and few seemed to have a comprehensive training regime.

On the whole we thought training was something of a Cinderella area for Tax Functions: Tax Directors have a concern about getting and keeping high calibre people but does not seem to translate into extensive commitments around training.

Question 38: How does your organisation manage the career aspirations and development of professional staff within the constraints of the Tax Function?

The big Tax Functions generally have some science around career development with individually tailored development plans and annual review programmes. Here, talent is identified and management applied to see that aspirations are met.

Smaller Tax Functions struggle more; offering less career management and a more resigned approach to a "dead man's shoes" situation. Typically, this results in younger talent having to move on to achieve progression. Perhaps the best that can be done in this situation is to try and keep staff as motivated as possible and make sure young talent keep their skills honed so they are as happy as they can be when they move on (and perhaps one day they may come back!).

Question 39: The following describe some of the features of a high performing Tax Function. How would you describe your department?

The questions here are based around a model that David Maister, a widely acknowledged authority on the management of professional service firms, kindly allowed us use. In David's book "Practice What You Preach", he developed a mathematical model that sought to prove, through careful mathematics, a causal relationship between the financial performance professional service firms and nine performance factors (set out in Maister's order of importance), namely:

- quality and client relationships;
- employee satisfaction;
- high standards;
- coaching;
- commitment, enthusiasm and respect;
- empowerment;
- fair compensation;
- long-term orientation; and
- training and development.

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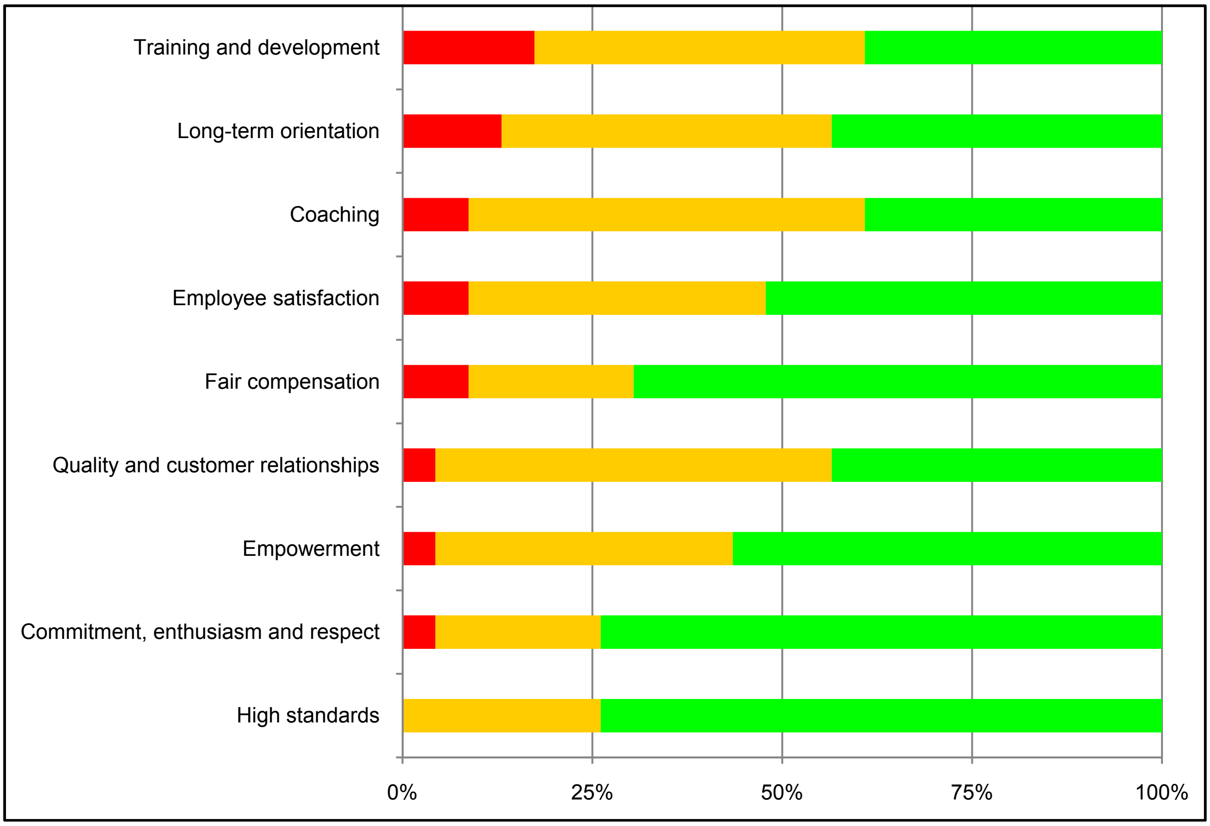
Maister's model demonstrates that a commitment to quality and client relationships is the single most important factor and a 1-point increase on a 1 to 6 measurement scale would result in a 104% increase in financial performance for the professional service firm (the next most important factors being employee satisfaction, driving a 42% improvement, and having high standards, driving a 40% improvement).

We believe there is a reasonable extrapolation that can be made between the performance of professional service firms and the performance of Tax Functions since a Tax Function is akin to a professional service firm how it advises and supports the Business. Further, a Tax Function is comprised of tax professionals similar to a professional service firm. We therefore felt Maister's model would shed interesting light on the areas Tax Functions might focus on to enhance their performance – particularly how Tax Functions felt about their performance in the areas Maister found key to the performance of professional service firms:

- quality and client relationships;
- employee satisfaction; and
- high standards.

The results we obtained in asking Tax Directors about their perception of the performance in their Tax Functions for all of the Maister factors is given in the graph below.



As can be seen, the worst performing areas are those around staff career management and development; and employee satisfaction and how aligned staff are with the objectives of the Tax Function as a whole. Given the fundamental importance of people to the Tax Function and its activities, we thought these results offer informative guidance on areas of focus for Tax Directors

Detailed Findings

seeking to enhance their Tax Function's performance. Certainly, Tax Directors should consider approaches to improving employee satisfaction for their teams since this is a key driver of performance. Perhaps fortunately given the difficulties Tax Functions seem to have in these areas, training and development and long-term orientation do not contribute significantly as a driver of overall performance so the poor results here areas may not be excessively detrimental.

The good news is the success of Tax Functions in maintaining high standards: this being a cultural imperative amongst tax practitioners probably being the underlying cause of this result.

However, given its predominant importance, we believe the key area of focus for Tax Directors is building quality and client relationships with the Business. We believe this performance factor is not only the main driver of Tax Function performance but it is also of growing importance in the modern world. And, Tax Functions aren't really good at it yet.