Think global, act global

Why middle market companies should build the tax function of the future today
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Think global – because you may already be global
Today, new technologies mean that a company can be multinational – even global – from day one of its formation.

The internet, cloud computing and other new technologies mean the business playing field has been leveled. Inbound companies can move quickly to enter markets where a local player has proven a workable business proposition; disruptive businesses move more rapidly than ever thought possible; and the trajectory from idea to operation to global corporation can be made in days or weeks, not years.

Like the world of business that it mirrors, the world of business tax is becoming unrecognizable from the one of just a few years past. The landscape as we know it today – and the new vista that will emerge – is being shaped by a convergence of trends and forces that are impacting tax departments at a faster pace, higher volume and greater complexity than any company has experienced before, whatever the size of the company.

Tangible tax changes are now occurring month by month, week by week and often day by day: tax transparency is becoming the “new normal.” Information on the cross-border tax rulings granted to a company in one European Member State will be available for all other revenue authorities to examine and, if the European Parliament has its way, will need to be disclosed in the company’s financial statements. And business fears that potential new rules on what constitutes a permanent establishment (PE) may be used by some countries to justify an overly aggressive approach to finding (and then taxing) PEs. These are just some of the new realities that companies must now deal with.

It’s not just multinationals

The impact of such change is not limited to the world’s largest multinational companies, though. Increasingly, middle market companies (which for the purpose of this report we have defined as those with annual revenues below a threshold of US$3b) now find themselves under the spotlight of public, media, tax authority or even internal scrutiny. The rising use of technology and data analytics means that governments and tax authorities are able to consistently lower the threshold at which this increased scrutiny occurs. Consider Schedule UTP (for the reporting of uncertain tax positions) in the United States, where the original asset threshold for filing dropped from US$100m in 2010 to US$50m in the 2012 tax year and to US$10m for 2014. Alongside new transparency and disclosure requirements, reputation risk has also become a phenomenon that many thought would pass quickly, but instead continues to draw companies large and small into its sights. All these factors put tax higher on the corporate agenda than it has ever been.

Outside national markets, some middle market companies also find themselves the focus of the Base Erosion and Profit Shifting (BEPS) project of the Organisation for Economic Co-operation and Development (OECD), where the minimum threshold for country-by-country reporting of financial data (which is to begin in 2017) has been set at €750m or the local currency equivalent.

Challenges mounting

Middle market companies are telling us that they are already facing significant pressures in how they manage their tax compliance and reporting responsibilities. Eighty-nine percent of global respondents to this survey have experienced a revenue authority review or audit in the last three years; 76% have experienced growth in the overall number or aggressiveness of tax audits; and 64% report an increase in cross-border focus by tax authorities. But not all stress points come from outside the enterprise: 73% say their organization has undergone some form of restructuring in the last three years while 67% report

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1 “Middle market” naturally means different things in different jurisdictions. For the purposes of this survey and resulting report, we are defining middle market as any company, irrespective of whether it operates domestically or across borders, with annual revenues up to US$3b.
Why middle market companies should build the tax function of the future today

conducting some form of finance transformation exercise. And a lack of internal processes and controls was the leading perceived cause of tax risk among survey respondents.

In this report, we seek to highlight not only how middle market companies address their tax operations – and compliance and reporting needs in particular – but to identify the skills, competencies, processes and technologies they will need to meet future obligations.

All multinational companies, however large they may be today, have experienced the process of learning and then mastering new tax challenges as they pass through the growth cycle from domestic company to small multinational to truly global company. Throughout our report, we seek to isolate and describe the lessons they’ve learned through their journeys. At the end of each section, we identify and describe the most important insights the world’s leading tax functions and their tax directors have shared with us. Through this process, we suggest that middle market tax functions support a minimum of four of The EY Seven Drivers of Growth (people, behaviors and culture; digital, technology and analytics; operations; and risk) – and many also contribute to the funding and finance driver.

These seven drivers represent the key business challenges companies must address and master in order to accelerate their growth. That the middle market tax function contributes so much to so many of these drivers is a testament to the growing importance of effective tax management.

A way forward

This is an incredible time to be running or working in a tax department, whatever the size of the enterprise – a time when tax has risen far up the agenda of corporate leaders, governments, media and the public. It is a period of extraordinary technical change and public and tax authority scrutiny, which must be effectively managed if the enterprise is to meet all obligations and manage its risk exposure. Tax is a double-edged sword: get it (and keep it) right, and an effective tax function can provide not only support to the wider business, but a real advantage over and above competitors. But get it wrong, and the pains – audits, disputes, penalties, inefficiencies, reputation risk – can be significant.

Having access to insights from those who have already trodden the same path can help in this period of evolution and change.

Aidan O’Carroll
Global and EMEIA Leader – Global Compliance and Reporting, EY
“I feel thin, sort of stretched, like butter scraped over too much bread.”

— J.R.R. Tolkien
The Fellowship of the Ring
Inside the middle market company tax function

*Due to rounding, not all figures may add up to 100%.*
The expansion pathway and its tax impacts

This publication seeks to help you obtain such insight and plan your route forward.

Today, tax department leaders must deal with a range of risks and obligations that were simply not on their radars just five years ago. Our survey of tax and finance executives extended far and wide, covering the many challenges that middle market companies face in ensuring their global compliance and reporting efforts fulfill their responsibilities wherever they operate.

Filing an on-time, accurate tax return is the sum of many moving and complex parts. From bookkeeping to accounting, and from financial reporting to actually filing the return, the “record-to-report” process that companies must develop, master and sustain is composed of many processes and subprocesses. Any one process can grow inefficient, disorganized or positively risky if scrutiny and care are not consistently applied. Achieving maximum control, value and efficiency in the tax function, at the same time as expanding market share or entering new products, services or markets, is a key challenge for middle market companies.

“Companies then get up to the level of being an established multinational company,” continues Doug Mastrangeli, EY’s Americas Leader for Global Compliance and Reporting.

“Here, it’s all about streamlining data exchange across all entities, starting to use data analytics, better connecting with a BPO or shared services center, and also thinking about optimizing both tax and controversy planning and legal entity compliance.”

Dobell, Duncan and Mastrangeli all believe that virtually every company seems to encounter common challenges at these inflection points. And while it may not be possible to define exactly when that inflection point may be for each individual company – and some companies may be growing so fast that they are only aware that they ever reached such inflection points via hindsight – the challenges do seem to occur somewhere around the point of expanding into approximately 10 countries, and again when the company is present in around 30 or more countries and is considered to be multinational.

Identifying key inflection points in the corporate growth cycle

Matthew Duncan of EY’s Global Compliance and Reporting group, works with a number of fast-growing international companies. He explains that he has seen a common growth trajectory around their finance operating model and how that in turn impacts their global compliance and reporting activities. That life cycle has three very specific inflection points: first, the company starts up in several local markets with almost the entire focus on growth and little time for compliance and reporting-related activities. Then, as the company continues to expand to more countries, it is increasingly aware of being in compliance and maintaining appropriate controls, but may not have the systems or infrastructure in place yet to really manage these tasks in an effective way. Finally, as the company starts to build more robust operations in each of the countries, it starts to become more of a true multinational, including building its regional or local finance operations. Each inflection point presents different challenges and different responses.
“While companies are initially primarily focused on growth and can't necessarily put all the infrastructure in place in advance, it is very worthwhile to be aware that the inflection points exist,” says Mastrangeli. “Unfortunately, what we tend to see more often is companies get to the point of being in fire-fighting mode, having outgrown their infrastructure and trying to fix things that have broken.” “It is always better to address the requirements in advance rather than waiting until you have missed payroll, delinquent tax filings or having to respond to audit notices without adequate supporting documentation,” adds Dobell.

Duncan goes on to describe how switching focus from the tactical to the strategic can be advantageous. “We have had some really great experiences where middle market companies have come to us for help on some very tactical issues, but we’ve been able to help them develop a more strategic approach by looking at their overall record-to-report process and finance operating model.

By working with the company to align their operating model and plug in our global resources as required, we have been able to help companies achieve better control, drive efficiency and cost reduction and refocus on operating the business.”

The tax agenda as a lens

A company’s tax agenda – the life cycle of accounting, compliance, provision and controversy, coupled with tax performance management and data management – provides a useful lens through which to view these survey results. This tax agenda is supported by the people, processes and technologies that continue to adapt and change to meet new business and legislative demands. All elements of the tax agenda will be under more pressure than ever in the coming years.

The tax agenda
Not surprisingly, 81% of the companies responding to our survey said they have a dedicated in-house tax function. Reflecting the range of new tax challenges that continue to unfold, the number of companies that say their tax resources have increased over the last three years exceeds the number that say they have decreased by a factor of more than 10-to-1 (42% vs. 4%). Fifty-two percent say tax resources have stayed at the same level. Sixty-six percent of those reporting resource growth say it came from professionals assigned to both tax planning and tax operations. Thirty percent saw an increase in resources assigned to tax operations (including controversy management) only, while just 4% saw an increase in resources assigned solely to tax planning.

Among Americas-based respondents, the divergence was more pronounced: 63% reported that the tax function has grown, while only 33% say it has stayed the same. Four percent said that it has decreased in size.

The “shadow” tax function
Dedicated tax function resources are but one part of the tax puzzle, whether the company generates US$30m or US$30b in revenue. The role of the shadow tax function also merits scrutiny. This group of individuals – typically finance personnel who may not be fully dedicated to tax activities, but who certainly help grease the wheels of the tax life cycle – sometimes attract less attention than they deserve.

Leveraged to its full advantage, the shadow tax function can provide both ongoing support and valuable on-demand, just-in-time support to dedicated tax resources. But left unmanaged, it can be a source of error and oversight. Thirty-seven percent of companies in our survey responded that between one and four of their headquarters-country tax team typically sit in the finance function. As 67% of respondents reported having an average only one to four dedicated tax resources to begin with, maintaining visibility and control of the shadow tax function is mission-critical. And of course, this fact becomes even more crucial when you consider that, whether a shadow tax function exists or not, the finance function usually performs all the upstream record-to-report activities that the tax department relies upon for accuracy in its data, so the tax-finance interface is a critical enabler in the process to get right.

Relationships
Eighty-one percent of global respondents report that their tax function has “excellent” or “good” relationships with the finance function, with that figure rising to 88% for Americas-based companies. But when asked about their relationships with other parts of the business (such as manufacturing, R&D, marketing or legal counsel), global results fell to 52%. As middle market companies expand, identifying and sustaining these relationships are imperative. Business units are the source of many future transactions and the epicenter of their execution. Likewise, upward communication to the C-suite, board and audit committee is also important, both in terms of gaining a better understanding of company affairs and to raise awareness of the changing world of tax. Having these relationships in place today is easier than trying to build them from scratch tomorrow.

Training
More than half of all respondents (54%) report that their tax function members receive less than 20 hours of training per year. Respondents based in Brazil, Russia, India and China (BRIC) reported the least hours of training, with 78% receiving less than 20 hours per year. Results also show that companies tend to provide more training the larger they are. The vast majority of training (79% of companies) was delivered by an external vendor or provider, while ad hoc reading of articles, publications and tax alerts was reported by 69% of respondents. Forty-two percent of respondents say that attendance on webcasts or similar virtual channels forms part of their training, while 39% deliver in-house training or seminars.

Performance management
Globally, 44% of respondents say that tax performance is formally measured, while 36% say that tax function performance is not formally measured. The remainder did not know the answer to the question, or felt it was not applicable to them as all tax activities were outsourced to an external provider.

Creating tax savings, lodging returns or regulatory filings on time, and having success in dealing with tax authorities were the three highest-ranked performance measures (in that order), with no more than 4% difference among the votes cast for the three. Meeting tax operating budgets, the availability of tools for creating the tax provision and peer benchmarking were the three lowest-rated performance measures.
Anticipate how expansion and business transformation may impact your tax talent

Today’s tax leaders think dynamically, work collaboratively with other business functions and focus on continually improving processes, whether these process are tax-owned or shared with finance function colleagues. Middle market companies should mirror the leading practices found in larger multinationals, designing tax hiring, training and succession road maps that anticipate their growing needs.

As middle market companies expand, operating models will naturally need to change. Shared services centers and centers of excellence may play their part. And while managing the complex and fast-paced relationship between tax and finance personnel has always been a challenge, the trend toward the transformation of finance operating models can put connectivity between these key groups under more pressure than ever.

Their good intentions aside, finance transformation exercises can negatively affect tax resources in two ways. First, and because of their very nature of regionalizing or centralizing activities, they can result in the loss of highly knowledgeable tax resources at the local level. As they standardize and consolidate their operations, companies are trying to do more with less. While this may be achievable (and desirable) from a cost perspective, it risks neglecting the fact that tax remains a highly national issue.

For instance, centralizing European finance operations may well make sense, but the fact remains that any company operating widely across Europe may expect to file almost 60 national-level tax returns each year, not to mention at least that many statutory reporting obligations. Without access to key local expertise and experience, many companies are now finding that meeting their record-to-report obligations in all the countries where they operate is a real challenge.

Second, the globalization or regionalization of processes can lead to an erosion of skills and competencies. “Take value added tax (VAT),” says Patrick Trapp, EY’s Tax Performance Advisory Leader for Europe, the Middle East, India and Africa (EMEIA).
The world’s leading companies are building and sustaining relationships that span all business units.

Anticipate how expansion and business transformation may impact your tax talent (continued)

“It could be that in the past, you had a very low probability of a VAT failure because the people who were taking care of the operation of VAT matters had a full department that had been there for a long period of time. They had a big staff, many of whom were cross-trained. Under a finance transformation, all of that activity may get moved to a shared services location, in a different part of the globe, with people who have been newly hired. That’s a real challenge. It’s not insurmountable, but if you ignore it, it can bite you.”

So, as middle market companies become newly multinational, they should make sure they not only bear in mind the impact of finance transformation, but they also have people in both global and regional roles to leverage talent and maximize accountability.

New trends, new skills

The growing use of technology in business models, by tax administrators and by the tax function itself, will also drive future demands for different skills. “In the future, tax professionals are going to need to be not only technicians and relationship managers, but also data and systems analysts,” says Tim Zech, Tax Director for Germany at Daimler AG. “Whether it’s due to country-by-country reporting, the use of a common consolidated tax base in Europe or just to get your arms around huge growth in data volumes, every tax function is going to need a strong technology competence in the future. The people who can move data around and manipulate it into the formats required will be hugely important moving forward.”

The rapidly changing tax landscape also means that some members of the tax department will need to have the skills to team extensively and effectively with external stakeholders, whether in the public or private sectors. The rapid growth of technology, too, will require the acquisition of new skill sets.

Finally, developing future talent will likely include more global mobility to grow key leaders. The tax department of the future should be a place where career satisfaction and talent development are key priorities. That requires putting the right mechanisms in place now. A culture that fully leverages available talent takes time to build.

Develop and sustain the right relationships throughout the business

As business models continue to evolve, the core relationship between tax and finance becomes ever more important. But more widely, the world’s leading companies are building and sustaining relationships that span all business units. Maintaining open lines of communication is not easy, however. Whether communication is solely within the tax function or between tax and finance or tax and marketing, companies of all sizes tell us that the simple fact that tax now has to juggle more and more sources of risk and more changes in legislation and regulation — all without adequate resources in place — is diminishing the time to effectively communicate with others on complex tax issues.

Having visibility of all parts of the business is an important foundation stone in the tax strategy of the world’s leading companies. “We align our tax resources to the business functions,” says Ian Brimicombe, Vice President of Corporate Finance at AstraZeneca. “Business partnering is the ongoing engagement whereby our tax team has responsibility for understanding activities within commercial, R&D, business development and manufacturing functions, as well as the enabling functions like legal, human resources and IT. Our objective is to achieve tax efficiency by mitigating risk and identifying opportunities to support business transactions.

“The business, of course, is focused on its own objectives, but we stay close to provide an interpretation of what their activities mean in terms of tax consequences,” he adds. “Generally, the business takes our tax perspective on board and adjusts the way it does things, so we’re able to support them in achieving their objectives and, at the same time, achieve our goals in tax efficiency. It’s a hand-in-hand partnership.”
The growing importance of technology will rightly drive many talent decisions for the foreseeable future. Technology and digitization are changing working methods. They are also supporting an increase in the use of managed services and outsourcing as companies shed lower-value, repetitive tasks. And of course, technology provides business with substantial opportunities to drive value and manage risk through exciting new data analytics opportunities. But each of these areas requires the fostering of new skills and competencies if business is to exploit opportunity to its fullest potential.

Simon Grimwood, Head of Tax, UK and Europe at Barclays, explains that it’s not just technology where new skill sets will be in demand. “One of the key skills for the future is that the tax function is going to have to be far more commercial,” he says. “In fact, that’s already happening. If you went back 15 years, you’d see a tax function that in essence was a group of technical experts who knew the law. But it’s coming through strongly now that not only do you need those people and those competencies, but you also need people who thoroughly understand the business, marrying up their technical competencies with a deep knowledge of your operations and strategy. That way, rather than giving just a technical answer, they can give what I would call an ‘actionable insight’ to management.”

Grimwood explains this principle: “The boundaries of tax are moving more into the business and are becoming more blurred. Rather than just giving a technical answer, people with these skills can offer a range of different options, all of which they know will work in a commercial environment. That’s far higher value to management than saying: ‘Here’s the tax answer; go and mold the commercials around it.’ On top of that, I think another useful skill for the future overlays this ‘actionable insight’ principle, and that’s the ability to communicate the essence of very complex tax principles in very simple commercial terms. That requires talking in the language of the business, not in the language of tax.”
All companies compete for talent. Middle market companies must attract the right tax talent to their organizations by making people feel excited, purposeful and responsible.

Identify the skills and competencies of the future (continued)

Similar thoughts are echoed by John Schlafly, Senior Tax Counsel for Europe for The Coca-Cola Company, who says, “Practicing tax no longer is just about being technically proficient in tax with respect to an isolated transaction. A tax practitioner needs to be able to set out the cross border tax implications of a transaction and be in a position to defend it, not only to the tax authorities of multiple countries, but potentially in the public square.” Schlafly continues: “This will require strong technical, negotiation and verbal skills, allowing one to make what will certainly be judgment calls in certain cases, which will inevitably need to be explained later in the light of 20/20 hindsight.”

Understand what drives your talented individuals – now and in the future

All companies compete for talent. Middle market companies must attract the right tax talent to their organizations by making people feel excited, purposeful and responsible.

The future will see flatter hierarchies and organizational de-layering. Today’s younger generation wants a higher degree of personal responsibility earlier in their careers. They want international experiences and work-life balance. And they want to feel that their work is purposeful and helps to improve society. All companies, regardless of size, need to look within and understand the changes that they need to make in order to provide that future platform.
The operating model as competitive advantage: a new battleground

A wide range of different drivers may cause a company to revisit and refine its operating model. Disruptive strategic and competitive pressures, access to a new “curve” (such as scale or talent), the misalignment of its existing operating model, the changing legislative environment, and numerous other risks and opportunities all create pressures to change. But for a middle market company, it is growth in and of itself that can most commonly trigger the need to transform.

Simply put, operating models define how and where you organize your people, organization, processes, transactions, technology, assets and intellectual property to run the business and deliver the underlying business model. Recent years have illustrated a number of key trends in the operating models that companies like those in our survey typically employ.

Some of the most visible trends in operating models today include the use of one of the following:

- Procurement hubs (either global or regional)
- Supply chain management companies, including multiple regional hubs
- Shared services centers
- Tax centers of excellence
- Export companies
- Multiple hub and cluster structures

While 67% of survey respondents report undertaking some form of finance transformation in the last three years, it is probably not surprising that, given their relative size in comparison to the large multinationals that tend to drive developments in operating models, the majority of survey respondents have not yet felt the need to put in place many of the models cited above.

That said, 25% of respondents do report regionalizing some part of their tax operations into a shared services center or similar model. Blaise Baudry, Region Tax Director – Middle East and Asia-Pacific (MEAP) Region for Baker Hughes, comments on this trend: “I would say that a decentralized tax operating model looks to be much more efficient than a centralized model, so I would recommend that middle market companies make sure to expand their team internationally and not only focus on their HQ tax function, as might have been the case for many years.”

Baudry continues, expanding on why he feels that way: “In my view, it helps reduce your risks as you get closer to the tax authorities, and you can make sure that you constantly keep in touch with them. It also allows you to develop your talent pool, which is a key for the successful tax function of the future. Middle market companies often rely on their corporate HQ tax function whereas they should make sure to develop overseas centers of excellence. The structuring of these centers should ideally match the development of their financial shared services centers, so as to leverage the relationship with global accounting. That way, you can make sure that tax will provide inputs to global accounting at the inception of the development of new technology and systems, and therefore ensure that the right tools are set up, allowing you to get better data analytics and be able to better face the challenges of the global transparency programs initiated by the G20 members.”
Key insights from business leaders

“To improve is to change; to be perfect is to change often.”

— Winston Churchill

Don’t let the tail wag the dog

One key principle for companies of all sizes to keep in mind is that the tax operating model should follow that of the business, not the other way around. But while that concept may sound simple, it hides a multitude of details with regard to just how these operating models are developing.

Many changes in operating models come about as the result of a finance transformation, which in turn can often be driven by corporate expansion; on this subject, a remarkable 83% of polling respondents at a May 2015 EY client event in Europe said their company had experienced a tax transformation project in the last three years. While that figure may not represent large-scale, global transformation, it is nonetheless significant, and was exceeded by the fact that 92% of those not involved in such a project in the last three years do expect to become involved in one in the coming three years.

Of those tax professionals who had already experienced some form of transformation, the time when the tax function was included in the project varied significantly — 33% say it was involved from the start, 33% said it was included at a later stage and 33% said it was included too late. These results, though derived from companies larger than those responding to the survey data underpinning this report, can be useful to bear in mind as middle market companies enter the space where these types of transformations become more urgent and important.
When the time comes, ask the right questions

A rapid transformation of the tax or finance operating model may not be the right solution for all companies. But for those that do choose to embark on the journey, a number of key questions may help frame the most important issues:

• Can value be unlocked from the operating model? Are there specific business activities that the tax function could streamline or support in a more efficient manner?

• Which new business processes, transactions and tools will be required to implement the new operating model? Is new investment necessary to build or buy them?

• Where and at which aggregation level will processes be managed? Is a market cluster, regional or global model the most appropriate form for the business?

• How will physical, financial and legal transactions flow, and do you have the technology to support this flow?

• Does the transformation create new legal-entity requirements? And if so, do these requirements, in turn, drive new tax compliance and reporting obligations?

• Which transfer pricing model and tax structure can best accommodate the future model?

• Which indirect tax and customs risks and opportunities does the model either create or solve?

• How will roles, responsibilities and service levels be organized? And how will you ensure you don’t lose valuable skills and competencies as you transform?

• Overall, does the benefit outweigh the cost?

Keep up to date on leading practices

Large multinational companies report a wide variety of emerging trends in the development of operating models, including the rising incidence of single-entity models, emerging signs of a move from regional hubs to market clusters with increased entrepreneurial characteristics, the use of global functional hubs to leverage scale as far as possible, the shifting of more tactical decision-making into shared service centers and the growth of omni-channel management.

Transformation by its very nature is one area of business that never stands still. Leading practices are constantly changing as global businesses constantly push the boundaries to drive higher levels of competitive advantage from their operating models. In this regard, leveraging the relationship they have with professional advisors – and the access to regional, global and sector-level insights that provides – will be key for middle market companies as they tackle this complex issue.
Survey highlights

81% of the companies responding to our survey said they have a dedicated in-house tax function.

54% of respondents report that their tax function members receive less than 20 hours of training per year.

78% of respondents felt they were “very likely” or “somewhat likely” to receive a revenue authority review or audit in the coming two-year period, while 65% foresee an increase in the overall number or aggressiveness of tax audits.

42% vs. 4% The number of companies that say their tax resources have increased over the last three years exceeds the number that say they have decreased by a factor of more than ten-to-one (42% vs. 4%). Fifty-two percent say tax resources have stayed at the same level.

44% of respondents say that tax performance is formally measured.

67% of survey respondents report undergoing some form of finance transformation in the last three years.

61% of respondents anticipate restructuring of their organization in the coming two-year period.

54% More than half of all respondents report that their tax function members receive less than 20 hours of training per year.

41% Transfer pricing attracted 41% more votes as the leading source of tax risk, ahead of indirect taxes, which include VAT, GST and customs.

66% of those reporting resource growth say it came from professionals assigned to both tax planning and tax operations. Thirty percent saw an increase in resources assigned to tax operations (including controversy management) only. Four percent saw an increase in resources assigned solely to tax planning.

67% of survey respondents report undergoing some form of finance transformation in the last three years.

25% of respondents report regionalizing some part of their tax operations into a shared service center or similar model.

91% of global respondents say they have experienced a revenue authority review or audit in the last three years, while 76% have experienced an increase in the overall number or aggressiveness of tax audits.

81% of global respondents report that their tax function has “excellent” or “good” relationships with the finance function, with that figure rising to 88% for Americas-based companies. But when asked about their relationships with other parts of the business (such as manufacturing, R&D, marketing or legal counsel), global results fell to 52%.

50% of respondents say tax risk management has become more important for their company in the last two years, while 48% say it has about the same level of importance for their company. Just 2% say it has become less important.
34% of respondents say tax has become more important for their company leaders in the last two years, while 60% say it has about the same level of importance for those leaders.

68% of companies say they have complete or substantial visibility over whether reporting and compliance obligations are being met in all jurisdictions in which they operate. While that figure may seem robust, it is should be considered against the fact that 25% say they have only partial or very little visibility.

75% of respondents say they have complete or substantial visibility over active tax disputes (including open tax audits) in all jurisdictions in which they operate. While that figure may seem robust, it is should be considered against the fact that 17% who say they have partial or little visibility.

Middle market companies report spending, on average, approximately 20% less time on tax compliance and reporting than large multinational companies.

In terms of the potential causes or triggers of tax risk within the company, a lack of processes and controls was the leading perceived cause, with insufficient tax function resources in second place. "Improved internal processes and controls" was rated the most important factor in securing improved global compliance and reporting for all respondents.

More than half (51%) of all middle market companies provide tax reporting, presentations or advice to the company board, audit committee or other key stakeholders on a quarterly or more frequent basis.

Managing strategic business transactions was reported as being the leading strategic focus area for the coming two years among middle market company tax functions. Transfer is the second most important focus area globally.

Local country bookkeeping and accounting are carried out by local finance resources in 66% of instances or by tax resources (10%). In only 11% of responding companies are they managed in some kind of hub (regional or other), while 10% use a mixed model, sharing bookkeeping responsibilities between internal and external professionals.

Corporate income tax return preparation is performed by local tax resources in 30% of cases. Local finance completes the tax return in 17% of cases, while 25% report use of a mixed model where responsibility is shared among company tax resources and those of an external service provider, and 24% report outsourcing the entire preparation and filing of the corporate tax return to such a provider.

Almost two-thirds (64%) of indirect tax return preparation is carried out locally, with tax professionals (33%) carrying out just 2% more of the activity than local finance (31%). Eighteen percent used a mixed model, while just 9% outsource indirect tax return preparation completely. Corporate tax return preparation is therefore more than twice as likely to be outsourced. Only 7% of global respondents perform indirect tax return preparation at a shared service center or hub.

More than two-thirds (67%) of statutory reporting (or preparation of financial reports for lodgment with a corporate regulator) is carried out locally by finance (48%) or tax (19%) professionals. Thirteen percent use a mixed model, while just 8% fully outsource this activity to an external provider.
Think global, act global
Why middle market companies should build the tax function of the future today

Indirect tax return preparation – an increasingly important area of tax, as governments turn their focus to taxing rising consumption of goods and services – tends to be carried out via a number of different models. Almost two-thirds of indirect tax return preparation is carried out locally, with tax professionals (33%) carrying out just 2% more of this activity than local finance (31%). Eighteen percent use a mixed model, while just 9% outsource indirect tax return preparation completely. Corporate tax return preparation is therefore more than twice as likely to be outsourced. Only 7% of global respondents perform indirect tax return preparation at a shared services center or hub.

More than two-thirds (67%) of statutory reporting (or preparation of financial reports for lodgment with a corporate regulator) is carried out locally by finance (48%) or tax (19%) professionals. Thirteen percent use a mixed model, while just 8% fully outsource this activity to an external provider.

Finally – and by no means least importantly – for the 83% of responding companies that are required to prepare company secretarial reports for filing with a local corporate regulator, 34% use local finance professionals within their organization for such preparation; 23% used a mixed model, with the responsibility shared between internal and external resources; 12% make preparation the responsibility of local tax professionals within their organization; while 12% outsourced preparation to their external tax advisor. In only 6% of responding companies is the preparation carried out in a shared service center, center of excellence or hub within the organization.

Overall, the middle market companies responding to our survey report spending, on average, approximately 20% less time on tax compliance and reporting than large multinational companies do. On this point, both the number and nature of tax and financial reporting obligations change as companies expand their size and geographic footprint. As middle market companies increase in size, they may wish to consider how the mix of their resources and focus may need to change and which opportunities there may be to outsource routine tasks.

All companies must manage the interaction between strategic aspirations and tactical realities.

Managing strategic business transactions was reported to be the leading strategic focus area for the coming two years among middle market company tax functions. Transfer pricing also ranks high, as the second most important focus area globally and the most important focus area for EMEIA-based respondents. Managing the effectiveness and efficiency of compliance and reporting (across both tax and regulatory dimensions) was the third most important focus area; all three were very close together.

Who's doing what?

When asked which tax compliance and reporting processes are performed by whom, respondents reported that local country bookkeeping and accounting are overwhelmingly carried out by local finance resources (66% of instances) or by tax resources (10%). In only 11% of responding companies are they managed in some kind of hub (regional or other), while 10% use a mixed model, sharing bookkeeping responsibilities between internal and external professionals.

Corporate income tax return preparation, however, is far more likely to be performed by local tax resources (30%). Local finance completes the tax return in 17% of cases, and leveraging an external services provider increases dramatically in this area, with 25% reporting use of a mixed model in which responsibility is shared among company tax resources and those of an external service provider. Meanwhile, 24% report outsourcing the entire preparation and filing of the corporate tax return to such a provider.

Therein lies a key part of the problem of managing tax, whatever the size of the enterprise: the recording of transactions (bookkeeping) is the overwhelming responsibility of one group (finance), while the reporting of income and profit is the remit of another (tax). Introduce frequently complex and fluid tax law, ever-changing enterprise-wide technology platforms and a lack of understanding of the importance of tax “sensitization” of data, and the result can often be that limited tax resources have to spend a great deal of time remediating data anomalies instead of adding real value.
In terms of the potential causes or triggers of tax risk within a company, the absence of processes and controls was the leading perceived cause, with insufficient tax function resources in second place.

In fact, middle market companies already seem to be moving in that direction. Whether through necessity or through choice, middle market companies are adding resources to assist with tax operations more frequently than with tax planning. In those companies where the tax function had grown in the last three years, 66% saw growth in resources assigned to both tax planning and tax operations, 30% saw an increase in resources assigned to tax operations (including controversy management) only, while just 4% saw an increase in resources assigned to tax planning only.

The incidence of “stress events”

We asked middle market companies to identify those events that, outside of day-to-day tax operations, sometimes require them to divert precious time and resources.

Tax authority scrutiny — via ad hoc reviews, formal audits or tax litigation — was reported as the most prevalent stress event globally, as well as being one of those with the greatest impact, especially among Americas-based corporations. Ninety-one percent of global respondents say they have experienced a revenue authority review or audit in the last three years, while 76% have experienced an increase in the overall number or aggressiveness of tax audits. This means that being on the front foot with all compliance and reporting obligations is absolutely critical, not to mention ensuring that any open disputes or controversies are accurately tracked, prioritized and cleared.

Considering that 61% of respondents have experienced some form of finance transformation exercise (such as a move to a shared services center or introduction of a new IT system) in the last three years, it is clear how crucial it is to secure and retain the right tax talent to deal with such an exercise.

Tax authority scrutiny appears equally high in terms of prospective stress events that may occur in the next three years. Seventy-eight percent felt they were “very likely” or “somewhat likely” to receive a revenue authority review or audit in the coming two-year period, while 65% foresee an increase in the overall number or aggressiveness of tax audits. Sixty-one percent anticipate restructuring their organization. That more than 6 in 10 foresee an internal restructuring is a testament to just how challenging life in a middle market company can be.

“The stress events you mention don’t surprise me at all,” says Richard Coney, Group Chief Financial Officer of Domino’s Pizza Enterprises Ltd. in Australia. “We have experienced a number of tax audits in our European operations, with France, the Netherlands and Belgium all demonstrating a really robust approach to scrutinizing our affairs. In addition, we have rolled out new tax technologies and moved our French accounting to our Dutch Shared Service Operation. So we certainly have to manage more complex issues the more we grow.”

Processes and controls

In terms of the potential causes or triggers of tax risk within a company, the absence of processes and controls was the leading perceived cause, with insufficient tax function resources in second place. A lack of communication or relationships with other parts of the business took fifth place, while it was the second-ranked reason in our 2014-15 tax risk survey of multinational companies, perhaps reflecting the difficulties in maintaining contact the larger an enterprise grows.

Insufficient processes and controls are one area where errors can be magnified as time goes on and enterprises expand. The right tax talent, however well deployed, will only be as effective as the policies a business puts in place and the processes it follows – and is measured against – in the fulfillment of day-to-day tasks. The design, deployment, management and measurement (and ultimately improvement) of effective tax controls require a clear understanding of the origins of the very risks those processes are designed to address and mitigate. Operational tax risk is driven by a variety of highly complex factors, all of which must be managed by proactive processes. At a high level, these factors include such issues as:

- Heavy reliance on data (both actual and forecast) from foreign jurisdictions, much of which may be provided exclusively by finance personnel, typically using a multitude of different software packages
- The necessity for high levels of tax account support, including identification of uncertain tax positions (for SEC registrants and countries where this is a requirement), return-to-provision analysis, fixed asset book-to-tax differences and accurate payables validation
Middle market companies’ use of external providers

When asked to describe their perceptions regarding the use of professional services providers, 50% of respondents said they prefer to sustain a “mixed” model, picking the best capabilities across both their internal resources and external providers. In the cases where an external professional services provider was engaged, 53% of respondents reported that the provider generally delivered above-average understanding and insight. Where an external professional services provider had not been engaged, it was not cost that was the key driver, but rather that the company felt its tax function already possessed a sufficient level of accounting and tax-specific knowledge.

The most important factors in securing improved global compliance and reporting

“Improved internal processes and controls” was rated the most important factor in securing improved global compliance and reporting (GCR) within all categories of firm size and in each geographic area except the Americas, where it falls far behind “greater use of technology and software.” “Securing better talent” is rated second-highest in Asia-Pacific while ranking lower in other geographic areas: third in the BRICs, fourth in EMEIA and fifth in the Americas.

The heavy reliance on data to meet compliance and reporting obligations is an area where middle market companies commonly feel the greatest growing pains. That being said, 79% of global respondents have “very high” or “good” levels of confidence in the accuracy and completeness of general ledger or subaccounts data available to tax professionals through their company’s technology systems. Sixty-five percent of global respondents say they have a “high” or “good” level of confidence in the willingness and ability of other functions in their company to increase the accuracy and completeness of general ledger/subaccounts data for reporting and compliance purposes once they are asked to change their approach by the finance or tax functions.

When asked about technology enablement to support data availability, 53% of global respondents say they have a “high” or “good” level of confidence in the willingness and ability of the IT function or resources in their company to improve the suitability of technology tools and systems to benefit the finance and tax function. But, as the English historian William Camden stated more than 400 years ago, “All the proof of a pudding is in the eating.”
Act with a clear purpose and strategy

Effective tax policies can help describe the role of the tax department across the entire business, as well as setting out information on tax operating models, responsibilities, processes and protocols for all elements of day-to-day tax management. Effective tax policies not only lend structure, guidance and instruction to the enterprise, they can also prepare companies to communicate more proactively with company leadership, but also in a more public fashion, should they either make that public relations choice or, indeed, be required to do so legally, as the United Kingdom is now discussing.

Data indicates that more than 6 out of 10 (62%) of the largest companies responding to EY’s 2014-15 Tax risk and controversy survey have either created or refreshed their tax risk policy during the course of the last two years. Of these companies, one-quarter had created completely new policies while the remaining three-quarters had refreshed an existing policy.

“Our goal is to revisit our tax policies continuously,” says Daimler’s Zech. “That means that, in principle, we want our tax policies to be updated not on specific events or triggers, but on a regular basis. But at least once a year, we initiate a top-down review process in order to ensure that tax policies are completely up to date and able to address any new developments.”

This is sensible advice. The twin worlds of tax policies and tax enforcement continue to change on a weekly basis at the present time. Acting in a clearly defined, documented and agreed manner is key to being able to manage so much change without unduly increasing overall risk exposure.

Lao Tzu

“Deal with difficult tasks while they are easy. Act on large issues while they are small.”
Identify whether certain tax processes could be performed more efficiently by a third party

An earlier section of this report noted that the number of companies that say their tax resources have increased over the last three years exceeds the number that say they have decreased by a factor of more than 10-to-1. While this data roughly tracks the experiences of larger multinational companies, it masks the fact that, while tax functions may more likely be growing than shrinking, multinational companies today are frequently choosing to outsource many tax processes in an effort to provide key tax function personnel with more time to drive higher-value activities.

Brimicombe explains how his organization decided which processes were most suitable to outsource: “Our global finance organization has been restructured to become much more focused on business partnering, decision support, investment appraisal and allocation of resources in markets. So for activities in the tax area, we felt it was more efficient to centralize responsibility for these deliverables and move to EY as a service provider. We could have built regional in-house tax specialist teams or perhaps a single hub or center of excellence where all statutory accounts and tax returns could be prepared.”

“However,” he continues, “we chose instead to leverage our Global Financial Service (GFS) teams, who process transactions and generate the core trial balance information, and in-market EY teams, who take that information and turn it into statutory accounts and tax returns. We chose this structure because the GFS teams were already in place, and we thought it best to rely on local expertise to deliver those services that need tailoring to dynamic local requirements.”

For some people, the notion of outsourcing may be a daunting prospect, or there may only be a temporary resource or skills gap, requiring short- to medium-term support on the ground. In many cases, professional services providers can assist with flexible resources, across the full range of tax and financial reporting needs, with the appropriate level of experience on a short-, medium- or long-term basis. This co-sourcing approach can also be a valuable way to support specific transactions or events, drawing on resources on an as-needed basis.

Institutionalize tax processes and controls

Establishing global standards and processes is the next step to gaining more efficiency and managing operational tax risk. The most successful enterprises build the mechanisms to institutionalize processes and controls right across the tax life cycle or across business functions.

That means setting global standards for statutory accounts preparation, including statutory tax provisions: there should be proactive and transparent monitoring of the key drivers of effective tax rates, cash taxes and risk that facilitates executive accountability and timely intervention where required. Successful businesses create a continuous improvement model that challenges the prior year processes.

Further, they re-establish quality in their existing numbers by validating tax basis balance sheets. These checks and balances also influence the content of more formal, written tax accounting policies and procedures. Finally, many tax functions may wish to assess whether the 2013 COSO report provides a fresh opportunity for tax to define the specific controls and processes that would help them partner more effectively with other parts of the organization.

“We have documentation in place which outlines the responsibilities and the limits of responsibility (or ‘non-responsibilities’) of each department within the tax function,” says Zech. “Based on this outline, each management position of the tax function has a more granular description of its area of responsibility, including for which group company or for which specific transaction types the person is responsible.”
Preempt how tax function focus areas may need to change over time

As companies expand—and, most especially, when they commence cross-border trade—there will be new areas of tax expertise that must be developed. These areas—such as dealing with transfer pricing issues, customs and excise duties or intra-group financing—will all require new and enhanced technical competencies, which the enterprise may choose to either buy or build. In addition, new tax obligations may also require new technology enablement and support.

A common piece of advice from tax leaders at multinational companies is that expansion into new products, services or geographies requires the enterprise to pay much more attention to detail across many areas. This includes the capacity of existing processes, the way in which documentation is assembled and maintained, and an overall enhancement to the way that tax function responsibilities are documented and measured.

Moving into a new market can be one of the most significant challenges (and opportunities) a middle market company experiences, sometimes with disastrous results. And while entering any market presents a number of new challenges, entering a developing or emerging market can compound the risks further.

As exciting a picture as entering a new market may present, operating in emerging markets is a leading source of tax and controversy risk. Because they are dealing with such rapid growth in inbound investment, emerging market countries tend to experience large volumes of tax policy and tax administration change as they develop the laws and processes to secure what they feel are the right levels of tax revenue.

It takes many years for a tax regime unaccustomed to policing cross-border commerce to mature, so some nations may rely on legislation and processes that some taxpayers may view as unsophisticated; complex; and, without a doubt, culturally different. But as emerging market countries become more confident in their own right, they are increasingly challenging commonly applied international standards. This has proven particularly true in transactions involving foreign-based companies, where some emerging markets are levying taxes on events that may previously have failed to trigger taxation. This phenomenon is becoming especially pronounced in the area of transfer pricing.

When it comes to managing tax function activities, the frustrations of entering into or expanding in an emerging market are legion. Companies typically have no dedicated resources with strong local tax knowledge or cultural experience, and the tax policy, legislation and tax administration processes can change rapidly as the host country develops at a high speed. In fact, companies in EY’s 2011 Tax risk survey said they frequently experience cases where no tax treaties are in place, and there are inconsistencies in legislation; ambiguous interpretation; and, in many cases, a lack of clear judicial and administrative guidelines about how to resolve a tax dispute, assuming a cultural approach supporting such collaboration exists in the first place. Language differences and the lack of a long-standing relationship between taxpayer and tax administration may further compound the difficulties of managing these tax issues.

Entering a new market can be one of the most exciting, yet perilous, activities for a middle market company. As local presence within the company is typically limited, pairing with a team of providers who understand the policies, processes and enforcement approach of the new country is paramount.
Embrace the trend of finance transformation

Finance transformation represents one of the key business trends of the last decade, but it is not solely a large-company phenomenon. Many middle market companies now realize that finance transformation – either in terms of a significant, strategic shift in either the purpose or the means of executing the finance process, or major process-level or IT-level modifications – can create a powerful competitive advantage.

Today, with many larger companies already far down the transformation route, many of the major external advisors in this space are entering the middle market arena, putting into effect lessons learned with the larger companies.

For the middle market tax function, the implications are many. First and foremost is the importance of tax relationships with business units and, perhaps more important, the C-suite, as was outlined in the “People and talent management for middle market tax functions” section of this report. Without that “seat at the table,” there remains the risk that tax is an added afterthought to finance transformation, if considered at all.

Second, and in keeping with the messages of the compliance and reporting obligations section of the report, it is critical that middle market tax leaders acquire and sustain a close understanding of exactly who is doing what, where and how in regard to tax processes, including those processes that may currently reside within the shadow tax function. Without a clear and up-to-date mapping of these processes, decision-making on elements that can be standardized, centralized and further technology-enabled becomes impossible. That can be a thorny issue and best tackled sooner rather than later.

Bigger company, bigger target on the radar

As outlined earlier, tax function focus areas may need to change over time. Transfer pricing may be a new issue to grapple with; cross-border financing will likely become a concern. And disclosure requirements become more voluminous and complex.

But as challenging as those topics are to manage internally, growth – especially growth across borders – also brings new levels of external scrutiny for the tax function to deal with. Here, the dimensions are multiple. At the multilateral level, new disclosure requirements such as the OECD’s country-by-country reporting (as well as similar obligations from the European Commission) may have to be met. At the national level, companies must also expect a whole new level of tax authority scrutiny as they engage in cross-border activities. On a purely domestic level, many countries have their own disclosure and transparency requirements that frequently impact middle market companies. For example, in the US, as previously mentioned, Schedule UTP, on which uncertain tax positions must be documented, was introduced in 2010, with a threshold affecting companies with more than US$100m in assets. That threshold was subsequently reduced to US$50m and today stands at US$10m. Factoring in these requirements – and their impact on resources, processes and technology needs – as early as possible can be one way for middle market companies to reduce the impact in advance.

As with all things tax-related, it is access to the knowledge of what is required in the first place that makes all the difference in the long run. Data integrity, too, is key; managing tax risks is a little like a spider’s web – pull on one part of the web, and another part moves.
How middle market companies use tax technology

The Americas-based middle market companies responding to our survey believe that greater use of technology and software is the most important factor in securing improved global compliance and reporting capabilities.

Tax technology tools must meet a wide range of needs. Specialist tools exist to support the creation of the provision. Tax consolidation software becomes necessary as companies grow. And the more data an enterprise generates, the more important scalable, integrated data warehousing platforms become.

But the needs do not stop there, particularly for companies that are rapidly expanding into new geographic markets. There, indirect tax engines become more important. Tools to track and support incoming tax authority requests can help mitigate risk. And data analytics can help companies make sense of growing volumes of data, helping them both reduce risk and identify opportunities to create value.

"Increasing our technology capabilities has definitely been key to supporting our growth," says Domino's Pizza’s Coney. "We have definitely been at the forefront of enabling technology that delivers a competitive advantage to the business. This is very apparent in the way we interact with customers at the point of sale, but also with our online ordering and social media capability. More recently, we have also been focusing on back-office automation, including optical scanning, logistics and process automation. These really help us streamline some of the tax processes that are becoming more complex as we expand."

Analysis of some of these key areas shows that our survey respondents have much work ahead of them if they want to feel confidence in overall systems readiness. And with reputation risk and new transparency obligations pressing upon companies more than ever before, having access to data as well as confidence in that data will be essential to avoid future controversy.

Accuracy and completeness of financial data

Before looking at the use of specific technology tools, some reflections on general confidence in this area can help set the context.

Seventy-nine percent of global respondents report “very high” or “good” levels of confidence in the accuracy and completeness of general ledger or subaccounts data. The figure is slightly higher among EMEIA-based companies, at 85%. Just 5% of global respondents have “low” or “very low” levels of confidence, with that figure rising to 12% in the Americas.

Where respondents felt that data quality could be further improved, 65% of global respondents say they have a “high” or “good” level of confidence in the willingness and ability of other functions in their company to increase the accuracy and completeness of general ledger or subaccounts data once they are asked to address those needs. Similarly, 53% of global respondents say they have a “high” or “good” level of confidence in the willingness and ability of the IT department to improve the suitability of technology tools and systems to benefit the finance and tax functions.

These relatively high figures may come as somewhat of a surprise when the technology tools typically employed by middle market companies are considered. Here, the prevalence of either stand-alone tools or templates based upon programs such as Microsoft Excel or Word can be viewed right across the spectrum of technology-enabled tax processes. This is a key area for middle market companies with cross-border aspirations to be aware of. As they do expand, the need for integrated, holistic tax technology tools and platforms becomes exponentially greater. Management by spreadsheet can quickly turn into death by spreadsheet.
This limiting approach to technology enablement is illustrated in the following key areas:

**Tax provisioning software**
Globally, 60% of respondents use spreadsheets or similar templates to prepare the tax provision, while in the Americas, 68% do. Globally, 6% use some form of internally developed technology tool. Twenty-five percent license a third-party tool, while 11% use a tool provided by a third-party professional services provider. Twelve percent of respondents use no tool whatsoever or make the provision preparation the responsibility of local tax professionals.

**Indirect tax software**
Twenty-three percent of global respondents use no technology tools at all for indirect tax compliance. Fifty-six percent use some form of internal spreadsheet or database, while 35% use some form of third-party tool, where 25% license it and 10% receive it from their professional services provider.

**Tax consolidation engines**
Thirty-five percent of respondents use no tool whatsoever to support the consolidation or make it the responsibility of local tax professionals.

**Document management systems containing appropriate information to support tax positions/returns**
Globally, 39% of respondents use simple word processing documents for document management, rising to 48% in Asia-Pacific; 9% use some other form of internally developed technology tool, while 27% license or purchase third-party software. Seven percent use software provided by outsourcing, accountancy or professional services providers, while 31% of respondents use no tool whatsoever or make document/knowledge management the responsibility of local tax professionals.

**Tools to enable and support requests for data from tax authorities and/or audit management**
Globally, 42% of respondents use spreadsheets or similar templates to help manage incoming data requests from tax authorities. This falls to 32% among Americas companies but rises to 48% in Asia-Pacific. Globally, 10% use some other form of internally developed technology tool, while 23% license or purchase third-party software. Just 5% use custom software provided by their outsourcing, accountancy or professional services provider. Thirty-four percent of respondents use no tools whatsoever or make the tracking of tax audits the responsibility of local tax professionals.

**Tools to enable and support tax modeling**
Forty-nine percent of global respondents use spreadsheets or similar templates to support tax modeling, while 7% use some other form of internally developed technology tool. Ten percent license or purchase third-party software, and that figure rises to 25% among Americas-based companies. Four percent use software provided by their outsourcing, accountancy or professional services provider, while 37% of respondents use no tool whatsoever or make tax modeling the responsibility of local tax professionals.

**Tools to enable and support data/transaction repositories (e.g., data warehouses, archive tools)**
Thirty-five percent of respondents use no tool whatsoever or make the use of data/transaction repositories the responsibility of local tax professionals. Twenty-seven percent use spreadsheets or similar templates, while 14% use some other form of internally developed technology tool. Twenty-seven percent license or purchase third-party software, while 7% use software provided by their outsourcing, accountancy or professional services provider.

**Tools to enable and support tax calendaring**
Forty percent of respondents use spreadsheets or similar templates to support tax calendaring. Four percent use some other form of internally developed technology tool, while 11% license or purchase third-party software, with this figure rising to 29% in the Americas but falling to just 2% in Asia-Pacific. Six percent use software provided by their outsourcing, accountancy or professional services provider. Forty-two percent use no tool whatsoever or make tax calendaring the responsibility of local tax professionals.

**Tools to enable and support legal-entity management**
Forty percent of respondents use no tool whatsoever to support legal-entity management or make it the responsibility of local tax professionals. Thirty-seven percent use spreadsheets or similar templates, while 7% use some other form of internally developed technology tool. Eighteen percent license or purchase third-party software, while 5% use software provided by an outsourcing, accountancy or professional services provider.
For many tax functions, though, achieving seamless access to multiple instances of different ERP systems is an area that is very difficult to achieve independently. At a minimum, it requires significant support from the finance function. Often, it requires some form of finance transformation process to deliver such an audacious goal.

Taken together, what do these responses tell us? A key takeaway is that very few middle market companies today use software tools and platforms that are built specifically to support tax activities. Instead, a significant number customize spreadsheets or local databases to get the job done. This is not a negative in and of itself. But when a company grows rapidly (and 47% of global respondents report that they are growing at a medium or fast pace), the need to move from a collection of stand-alone, proprietary tools to a platform that can truly manage tax needs across multiple borders can create a significant time and investment roadblock – just when the company wants to be moving as nimbly and efficiently as it possibly can.

An old adage holds that a database is only as accurate as the information input. This is especially true in tax, where the wrong data can lead to penalties, interest, disputes or even reputation risk. Today, successful ERP implementations have become a prerequisite for high-performing companies, and without a doubt, they play a mission-critical role in the enterprise-wide business operations of every single multinational. But not every company has a consistent, global implementation, even if they have implemented the same package around their enterprise and across jurisdictions. The result is that tax functions must typically interact with multiple standards and spend valuable time translating them into a common structure or data definition. Even when tax has access to these systems, the data management challenges can be daunting.

While the majority of tax professionals have built their careers on strong tax technical skills (getting the numbers right), the operational aspects of a strong tax function (keeping the numbers right) are also of major importance. A tax “value zone” occurs when strong tax planning is supported and sustained by strong tax operations. In many companies, this value zone presents a useful business case for integrating tax processes into financial systems.

The benefits can be numerous: on the income tax side of the equation, they include, among other aspects, improving the legal-entity structure for tax planning, reporting and compliance; managing jurisdictional tax liabilities; more closely tracking utilization of tax net operating losses, incentives and credits; greater support of transfer pricing positions; and streamlining tax and regulatory compliance generally.

These benefits are also supplemented by operational benefits, including better alignment of transactional pricing for transfer pricing, customs and VAT; more accurate tax calculations on transactions; and the ability to establish standards and controls over calculations.

For many tax functions, though, achieving seamless access to multiple instances of different ERP systems is an area that is very difficult to achieve independently. At a minimum, it requires significant support from the finance function. Often, it requires some form of finance transformation process to deliver such an audacious goal.

The value – as well as the risks – that technology may bring to an enterprise is unlimited. Moving forward, having ready access to accurate data will be more important than ever. Disclosure and transparency will continue to grow, and the use of electronic auditing initiatives, such as the Standard Audit File for Tax (SAF-T), represents the next era of tax payer to tax authority communication.

All things considered, and whether part of a finance transformation exercise or otherwise, now is the time to form a future technology strategy.
Using tax technology:

Key insights from business leaders

1. Have a tax technology strategy or road map

All middle market companies should consider building an effective data management strategy that uses a tax technology framework to support the entire tax life cycle of planning, provision, compliance and controversy. Only with such a strategy in place can the trials of rapid growth be most effectively managed.

Through a robust and sustained strategy, a middle market tax function can gain many benefits. These include:

- Improving data collection and data quality at the legal-entity level, supporting both forecast and interim reporting activities
- Automating the tax effects of intercompany profits, particularly when technology implementation is a shared effort between the tax and finance functions
- Developing tax “self-serve” data collection competencies and systems that provide for enhanced flexibility to access required data
- Ensuring proper controls over technology applications that comprise the overall provision model

“The first rule of any technology used in a business is that automation applied to an efficient operation will magnify the efficiency. The second is that automation applied to an inefficient operation will magnify the inefficiency.”

— Bill Gates
Detailed, high-quality, tax-sensitized data is critical to successful mitigation of operational tax risks. Successful businesses build an effective data management strategy using a tax technology framework to support the entire tax life cycle. In some cases, data systems could be better designed or consolidated.

But, generally, quality data accurately and efficiently tracks direct tax payments; monitors transfer pricing arrangements; tabulates indirect taxes, including value-added tax collections and remittances; records credits and incentives; enumerates withholding taxes; and codifies statutory account differences between International Financial Reporting Standards (IFRS) and GAAP.

In many cases, dedicated data repositories may be considered in order to support tax planning and audit teams. In the leading cases, companies should be able to rely on data to evaluate transactions as originally recorded in ERP systems, through the lens of the audit approach taken by tax authorities. This is a particularly important issue for European companies, where a growing number of tax administrators are starting to rely more heavily on electronic auditing, taking standard audit files for tax (known generally as SAF-T) from corporate ERP systems. SAF-T is an international standard for the electronic exchange of reliable accounting data from organizations to a national tax authority or external auditors.

Wherever the opportunity exists to do so, middle market companies should replace spreadsheet consolidation and email-based workflow with world-class tax technology that includes global tax provisioning tools and indirect tax determination engines. They should also consider how best to use workflow management tools to enhance global visibility, accountability and content availability.

Acting global – and implementing scalable, global technology solutions as early as possible – can be one of the most important differentiators for middle market companies. Having the right technology infrastructure in place can mean that growth-supporting activities can be focused on at the appropriate time, rather than having to create or scale disparate systems as the enterprise grows. For many, this means considering a move to a single ERP platform. While this may be considered an extremely bold and audacious step, it is one that can pay dividends if the enterprise meets or even exceeds its expansion objectives.
Think about data analytics opportunities sooner, not later

This standard is defined by the OECD and is now increasingly being adopted within European countries as a means to audit tax returns electronically. The standard was adopted in 2008 by Portugal and has since spread to other European countries, including Austria, France, Germany and Luxembourg. Similar obligations already exist in Brazil, Canada (on a voluntary basis), the Netherlands (optional), Poland, Singapore and Sweden. Discussions regarding SAF-T are also taking place in Belgium, Croatia, Finland, Lithuania, Malta, Spain, the Slovak Republic, Slovenia and the UK. This is a growing phenomenon, and the rising use of technology tools by tax administrators will support its growth for years to come.

At a high level, all companies should strive to improve data collection on a legal-entity basis for the purposes of forecasting and interim reporting. They should automate analysis of the tax effects of intercompany profits by working with the finance function. They should develop tax self-serve data-collection competencies and ensure they have proper controls over technology applications comprising the overall provision model. There should also be extensive tax participation whenever data requirements are created or revised, or ERPs designed, to make sure the data is suitable for use.

While the tax function may not be the primary user of data analytics tools within an enterprise, many of those exceeding the €750,000 threshold for country-by-country reporting under BEPS Action 13 are employing data analytics to identify outliers in the data reported under BEPS Action 13. Others are employing the same tools to try and uncover value from tax data in many other ways, including transactional analytics; tax reporting analytics; risk analysis and monitoring; supply chain analysis; transfer pricing analytics; or other bespoke, targeted analytics in areas such as pricing and margin modeling for new indirect taxes. As the 2013 MIT Sloan Management Review survey found, 67% of companies gained a significant competitive advantage from using such analytics.

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EY’s 2014-15 Tax risk and controversy survey, which included more than 950 respondents in 25 countries, indicated that the tensions described in previous years pale in comparison to the tax risks that companies say they are currently experiencing or anticipate facing in years to come.

Eighty-one percent of all companies polled in that survey agreed or strongly agreed that tax risk and controversy will become more important for their companies in the next two years. Middle market companies strongly echo those sentiments.

The results of this middle market company survey offer a glimpse of the hazards that must be overcome to safely navigate the next steps of the journey. But it is also clear from the findings of both our surveys that many enterprises may wish to consider enhancing their preparations and their tools in order to bridge the divide between current and future risk management frameworks.

Tax risk management never higher on the agenda

Importantly, tax corporate governance, tax risk and tax controversy management all hold high spots on the agenda of middle market tax functions. Fifty percent of respondents say tax risk management has become more important for their company in the last two years, while 48% say it has about the same level of importance for their company. Just 2% say it has become less important. Companies located in the BRIC nations and in the Americas say it has become more important to them than the global average, with 59% and 60%, respectively, saying “more important.”

To a certain degree, that high level of importance translates into increased attention from middle market company boards and audit committees. Here, 34% of respondents say it has become more important for their company leaders in the last two years, while 60% say it has about the same level of importance for their company.

Effective tax risk management relies to a great degree on visibility into whether obligations are being met and whether tax authority scrutiny is resulting in audits, disputes or even litigation. Sixty-eight percent of companies say they have complete or substantial visibility into whether reporting and compliance obligations are being met in all jurisdictions in which they operate. While that figure may seem robust, it should be weighed against the fact that 25% say they have only partial or very little visibility.

Where a compliance obligation has resulted in a dispute, visibility does seem to increase, but only marginally; here, 75% of respondents say they have complete or substantial visibility into active tax disputes (including open tax audits) in all jurisdictions in which they operate, vs. 17% who say they have partial or little visibility.

The leading sources of tax risk

So what are the tax issues that middle market companies believe are the leading triggers of risk? Here, transfer pricing completes the trifecta for the leading source of risk in three successive EY surveys. First, this is consistent with the findings of EY’s 2013 Global Transfer Pricing Survey of transfer pricing professionals. The second occurrence of transfer pricing as the leading tax risk appears in EY’s 2014-15 Tax risk and controversy survey. In fact, in our middle market company survey, transfer pricing attracted 41% more votes than the leading source of tax risk, ahead of indirect taxes, which include VAT, goods and services tax (GST), and customs. And while issues such as permanent establishment risk and withholding tax risk may have scored relatively low (both earned less than one-third of the votes of transfer pricing), they are nonetheless issues that middle market companies should be aware of as they expand across borders.

Indirect taxes can be a leading source of controversy in many markets. “We have certainly noticed that many tax administrators are starting to focus on smaller companies more than in previous years,” says Richard Coney of Domino’s Pizza. “A prime example is that we have noticed increased activity around GST audits in our franchisees in New Zealand and Australia. It certainly doesn’t stop there though; this seems to be becoming a far more pervasive theme virtually everywhere.”

Tax risks vary by geography: among respondents in BRIC nations, indirect taxes were deemed to be the leading tax risk, ahead of transfer pricing. But among companies located in the Americas, transfer pricing was by far the most common response, with “tax havens/low-tax jurisdictions” gaining second place.
Managing operational tax risks

Tax risks can find their genesis either outside the enterprise—in terms of aggressive tax enforcement, or legislative or reputation risk, for example—or inside the company. Inside, operational tax risk (defined as the many internal challenges that companies face in achieving an accurate record-to-report process for their tax and statutory reporting obligations) has wide ramifications for businesses large and small: every company has to deal with it, and few do it with absolute certainty in such a changing landscape.

Although there has been a steady decline in the number of material weaknesses specifically related to US GAAP since 2005, taxes continue to be the most prevalent of the US GAAP failures reported: more than half of tax material weaknesses reported in the US today, in fact, are driven by a lack of review or of personnel or poor process execution.

Operational risk covers not only financial statement reporting but all reporting to governments and governing bodies. For example, more than 60% of VAT errors leading to adjustments are due to mistakes such as incomplete invoices or receipts, or errors in applying tax rates. It has always been a challenge to get the right people, processes and technology in place to properly define, align and source the financial information that must be reported to regulators, investors and tax authorities in every business line and jurisdiction where a company operates.

In many ways, the three leading sources of operational tax risk identified by middle market companies (a lack of processes or controls, insufficient tax function resources, and the inability to monitor and react to changing legislation, in that order) largely reflect the same issues experienced by larger multinational companies. The exception to this rule is in relation to communication with the rest of the business; this issue was the leading cause of operational tax risk for multinational companies in EY’s 2014-15 Tax risk and controversy survey. Among middle market companies, however, it reaches no higher than fifth place, reflecting the relative ease of sustaining high levels of communication within a smaller enterprise.

Geographical dynamics again affect the sources of operational tax risk our respondents face. Among companies located in Europe, for example, the “ability to monitor and react to changing legislation” is the leading source, while among Americas-located companies, “insufficient tax function resources” is the highest contributor to operational tax risk, followed closely by “changes within business operations or strategy that are inconsistent with implemented tax planning.”

Tax corporate governance

In terms of effective corporate governance, more than half of all middle market companies provide tax reporting, presentations or advice to the company board, audit committee or other key stakeholders on a quarterly or more frequent basis. Thirty-eight percent of respondents provide a quarterly update (this figure rises to 56% among BRIC-located companies), while 13% provide a monthly update. At the other end of the spectrum, 23% provide tax reporting, presentations or advice on an as-needed basis only, while 3% provide no reporting.

Base erosion and profit shifting

No discussion on tax risk management would be complete without reference to the OECD’s BEPS project. Here, 43% of respondents believe BEPS will “significantly” or “somewhat” increase their levels of risk, with just 4% of that total coming from the “significantly” camp of voters. That 4% increased to 17% among Americas-located companies, however.

While 21% believe that BEPS will have no impact on their overall levels of tax risk, 35% said they did not know one way or the other. That figure rises to 60% among BRIC-located companies.

The relative lack of concern—or knowledge—regarding the impact of the BEPS project is reflected in the limited volume of activities that respondents have undertaken in response. Thirty-six percent of respondents have neither evaluated nor made changes to existing structures or positions, while 25% have evaluated existing structures or positions but have not made any changes. Just 8% have evaluated existing structures or positions and have made changes, while 28% responded that they did not know what their company had done in relation to BEPS. While this may be understandable for many middle market companies, many will soon reach the size where the BEPS project has an impact. Understanding and reacting to the potential impact as early as possible will be key to continued smooth sailing.
A robust tax risk management framework begins with a clear tax strategy and supporting policies that are endorsed and supported by the board of directors. There should be strong tax corporate governance in place, as well as an effective framework for identifying, reporting, prioritizing, remediating and generally managing tax risks. A company’s tax policy and risk tolerance should be aligned with the wider finance and business risk agenda. It is critical, however, that the tax function own the drivers of tax risk and value.

Policy statements should be reviewed and revised where necessary to meet increased demands for transparency, such as country-by-country reporting. Finally, companies should have the right technology in place to monitor their tax activities in order to demonstrate adequate oversight over key elements of their tax policy.
Many companies that have already standardized and centralized their global compliance and reporting obligations are finding that applying the same approach to global controversy and dispute management can deliver value.

2 Address tax risk management as a strategic issue

Tax corporate governance is rapidly becoming a leading practice among companies of all sizes. Key elements of an effective approach in this area include either developing or reviewing the company’s tax risk management framework regularly, measuring whether it effectively mitigates tax risk, confirming that all directors understand the company’s tax risk appetite and have endorsed a tax strategy, implementing formally documented tax corporate governance policies that operationalize the tax strategy, and embedding formal and regular reporting to the board and/or audit committee on tax issues.

In addition, many companies that have already standardized and centralized their global compliance and reporting obligations are finding that applying the same approach to global controversy and dispute management can deliver value. These companies understand that a tax inquiry, dispute or even litigation are all natural extensions of filing a tax return. Therefore, they are applying the same tracking, process and management protocols to controversy management, resulting in a more strategic approach to this complex area.

Enterprises will need to flawlessly execute a well-thought-out, well-resourced tax risk strategy while remaining flexible enough to deal with today’s changing conditions. Some short-term actions may include:

- Assessing how the company will comply with new transparency demands, such as country-by-country reporting and transfer pricing documentation requirements, without inviting unwarranted challenges to previously taken positions and without consuming so many resources that oversight of other tax areas is sacrificed

- Determining tax function readiness in terms of the key components of the BEPS Action Plan, as well as the growing number of related new obligations being put in place by the European Commission

- Assessing whether the company’s current and previous transactions will stand up to increased business purpose requirements – even where those requirements may sometimes seem to be highly subjective or even arbitrary

- Making sure the company has the right tools in place – such as advanced pricing agreements, rulings or pre-filing agreements – to manage through impending technical changes

- Making sure the company has enhanced visibility and control of any active disputes or uncertain tax positions around the world
Think global, act global

The tax department used to be seen as somewhat of a “black box.” Compliance obligations were met, and tax-effective structuring was a welcome, if secondary, added benefit. It was rare, however, for tax to visit with the board or audit committee.

Today, the possibility that a major tax dispute could wipe out 20% of the share price of a company or that a company’s tax strategy could land it on the front page of a newspaper or even in front of the legislature means that tax has climbed rapidly up the corporate agenda. That in turn provides a need (and an opportunity) for tax leaders to capitalize on heightened visibility.

This is not a call to tax leaders’ vanity. It is a straightforward, considered fact: tax represents a major business expense; tax has become more visible, and compliance costs will increase as a result of the global focus on tax issues. So it makes sense for the middle market tax function to engage early and often with company leadership.

It makes the most sense for the tax function to highlight the need for a stronger relationship as early as possible. The more sustained the relationship with company leaders, the more likely it is that tax will be brought into the decision-making process earlier.

Embed tax risk thinking into everything you do

Creating a whole new risk-focused mindset and culture within the tax function is a challenging yet worthy cause. But ensuring that non-tax professionals – particularly those in upper-level management – proactively consider tax risks when considering a merger or acquisition takes the philosophy one step further. That kind of dialogue must be initiated, revisited and sustained if the tax function is to properly and actively assess the tax risks of ongoing business decisions.

Make sure tax has a seat at the leadership table

The clock is now ticking on BEPS Action 13, and companies that exceed the €750m reporting threshold must urgently address their ability to submit indisputable data.
Why middle market companies should build the tax function of the future today

5 Prepare for the new world of tax transparency

As the “fair tax” debate has evolved, many stakeholders have concluded that more tax transparency is one of the many answers to this complex issue. But these stakeholders have different interpretations of what that may actually mean in practice. They also disagree about the appropriate level of transparency necessary to assure all stakeholders that companies are following the tax laws – both as written and as intended.

Demands on the tax function, of course, center upon BEPS Action 13, in which recent implementation guidance has now created a stable set of requirements against which companies can start preparing where necessary.

Additionally, the final form of BEPS Action 13 may require the national-level disclosure of aggressive tax planning arrangements. This is an important point, one on which European companies may do well to learn from their Australian and US counterparts: the disclosure of tax positions, whether classified as “uncertain” or “reportable,” will be required – and may well lead to additional tax authority scrutiny.

The clock is now ticking on BEPS Action 13, and companies that exceed the €750m reporting threshold must urgently address their ability to submit indisputable data. At a European EY client event in May 2015, 76% of polling respondents said they were already running pilot schemes in relation to Action 13, while 77% said that additional people resources will be required to ensure they are able to meet new data reporting requirements.

Eighty-three percent said their information systems will require refinements or changes to ensure they are able to source the required data in a timely and accurate fashion, meaning only 17% currently had confidence that they were already in a solid position. New developments and obligations – not to mention day-to-day business – will surely chip away at any buffer of time.

6 Actively monitor the changing landscape

Successful ongoing monitoring of the range of multilateral and national tax proposals and legislation is fast becoming an important benchmark for the leading tax functions. But more than just monitoring, the processes to react, assess and embed those changes across the tax life cycle are equally important. This includes not only tax legislation and tax administration “intelligence” of revenue authority focus areas, processes and approaches. It extends to the real-time monitoring of more specific issues – such as making sure the transfer pricing policy is properly implemented, national changes are responded to and the transfer prices charged match the model set on a real-time basis.

Today, the possibility that a major tax dispute could wipe out 20% of the share price of a company or that a company’s tax strategy could land it on the front page of a newspaper or even in front of the legislature means that tax has climbed rapidly up the corporate agenda.
“A man who procrastinates in his choosing will inevitably have his choice made for him by circumstance.”

— Hunter S. Thompson
Conclusion: seeking, not blundering
Growing and changing can be an uncomfortable process, but today, companies are experiencing both edges of a very sharp sword.

Growing and changing can be an uncomfortable process, but today, companies are experiencing both edges of a very sharp sword. Growing a business — expanding it from domestic to multinational aspirations — is supported by new technology and communications protocols that did not exist 10 years ago. But governments are also reacting to the fact that people and capital are more mobile than ever and that tax regimes designed for a world without such global connectivity may have fallen behind and are now being updated.

As middle market companies pass through the growth cycle and move from a domestic to a multinational footprint, we believe the insights and recommendations in this report will position them well for future growth, not to mention resilience. And, as with any business strategy, the earlier these actions are put in place, the higher the likelihood of future success.

These insights offered by tax leaders from around the world all point to one overarching theme: converging trends require a global outlook on everything the tax department does. A single sale across borders can generate a great deal other than profit: new data, a risk of establishing a PE, a possible new tax obligation.

Having the mindset, processes and technological capabilities ready to tackle the issues created by rapid growth is key for middle market companies that want to move at the highest speed possible.

The American humorist Sam Levenson once said, “You must learn from the mistakes of others. You can’t possibly live long enough to make them all yourself.” This is very good advice, and the world’s tax leaders are always seeking inspiration among their peers. Just as training with an athlete who is faster or stronger or who can run farther can help improve your performance, much the same is true in business.

We hope you are able to take inspiration and insight from the collective thoughts we have presented here. The coming years look set to present real challenges for tax professionals around the world. And though past results are no guarantee of future performance, there is no doubt that learning from those who have already trodden the path can be of real benefit.
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The EY Middle Market survey was conducted from October 2014 through January 2016 using written questionnaires and executive interviews. Responses were received from 270 companies, located in 26 markets, with annual revenues ranging from US$50m to US$3b.
EY extends sincere thanks to the companies and individuals who kindly provided insights and input for this report:

*Although not representing middle market companies, we thank these tax leaders for sharing their career-wide insights and experience with us.*

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- **John Schlafly**
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- **Simon Grimwood**
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- **Tim Zech**
  Tax Director Germany, Daimler AG

*Thank you!*
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