

Outsourcing becomes luxury in recession

Joanna Faith finds out the pros and cons of outsourcing in-house tax functions in a recession

External advisers can provide a lifeline to tax directors of multinational companies. "We operate in over 90 countries and not every country has its own tax department," says Ian Brimicombe, tax director at AstraZeneca, a pharmaceuticals company.

For Brimicombe and many of his peers, outsourcing tax functions to a consultancy firm in smaller, more obscure regions is their only option. But it does not stop there. The majority of tax directors in multinational groups sub-contract at least one function in every country they operate in: Tax returns, VAT compliance, transfer pricing documentation, M&A activity and corporate tax compliance are just some of the areas assigned to external advisers. Which functions are outsourced depends on the size, culture and nature of the company.

As the recession persists, managements are enforcing stricter budgets. All departments are reviewing their processes to find ways to reduce costs and save money. Outsourcing is an area where companies can limit expenditure. But reducing external advice can put more strain on an already overburdened tax department. In a time where just a small mistake can have a significant impact on an organisation, is now the time for companies to be scaling back on external advice?

An extra pair of hands

Tax departments have to be more stringent than ever when accounting for costs thanks to the economic downturn. "It used to be they worked on more of a no-budget basis," says Dorothee Traverse from the French law firm Moisand Boutin. "Now all budgets have to be approved." More often tax directors have to make value propositions to management about the advantages of using consultancies. Advisers argue they add value and can help save companies money. At a time when cash is king, it is up to tax directors to convince their bosses.

An advantage of handing over work to an adviser is it frees up valuable people and time. "Tax departments have a limited amount of resources and they have to pri-

oritise," says Andrew Wiggins from PricewaterhouseCoopers in the UK.

"Tax departments do not have to spend extra time or money training current staff if they outsource," says Robert Smoczynski, head of the tax & legal department at Deloitte in Lithuania. This is especially important if companies have had to make redundancies. Tax directors agree. In times of recruitment freezes, external advisers can offer a much needed helping hand. "There's a freeze on hiring in the corporate office," says Owen Murphy, head of tax at AngloGold Ashanti, a mining company. "You could say we are outsourcing more as a result."

"Companies' first survival instinct is to slash consultancy spending deeper to preserve the headcount they have," says Jim Eberle from Alvarez & Marsal Taxand in the US. But this might not be the best course of action. Whereas internal staff cost companies in taxes and social security contributions, outsourcing companies take care of themselves. "Outsourced employees do not ask for benefits or compensation," says Smoczynski.

No one can predict when the recession will end. This leaves companies facing an uncertain future with the possibility of more volatility. An advantage of outsourcing rather than firing internal resources is that if the state of the company declines, there is no need to make redundancies. Firing staff can leave the remaining workforce unsettled and have negative consequences on the company's reputation in the market. "If you outsource you can just terminate or alter the contract in seasons of peak and downturn," says Mukesh Butani from BMR Advisors in India. But companies may choose to reduce employees as a way of showing the market they are saving on costs. "Tax work is not reducing in the crisis so they may want to externalise some of the tax department," says Traverse.

Adding value

Much of a corporate's tax work is mandatory, few functions can be set aside for when the economy improves. Everyday tax compliance and reporting continues. "Just because there's a recession, it doesn't

change the fact that you still have tax filing obligations," says Alex Yuen, regional director of tax for Disney in Asia Pacific.

Outsourcing allows tax directors to concentrate on strategic tax decisions. Yuen is responsible for Disney's tax position in several jurisdictions including China, Japan, Australia and India. He does not know the intricate details of the tax codes in all these countries so he relies on outsourcing. He thinks it's important, especially in a recession, for tax directors not to get bogged down. "It's important to look at strategy at the moment because if companies are looking at cleaning things up, now might be a good time when valuations are lower," Yuen says.

Designating functions to an external consultant ensures the tax team is concentrating on the areas that add value, which is essential in a downturn. "More and more groups are focusing on forecasts," says Wiggins. "Companies don't spend huge proportions of their time forecasting in good times, when everyone is making money."

"But if every penny counts you have to make sure you know how much you are paying, where you're going to pay it and when it needs to be paid," he says. Eberle says tax directors in a downturn need to concentrate on the important functions such as tax planning and analysis. "They want to reduce the time spent being a tax clerk."

No room for error

Companies need to be confident that every decision is accurate in unstable economic times. A small oversight can have an overwhelming effect on an organisation. Even if a group has reduced its use of consultancies, it will still seek a second opinion on technical matters. Murphy has been put under pressure to slash his consulting budget by about 20%. But the bottom line is if something needs to be checked, he gets it checked.

"If things aren't checked my boss could go to jail," he says. He is more careful about deciding on what needs a second opinion. But it is a very fine line, he admits. "If you make the call not to get the second opinion, it could have disastrous consequences."

He tends to err on the side of caution. "If

"I exceed my budget, my boss will thank me when he doesn't go to jail." Traverse has witnessed groups doing as much as possible internally but, she says, they still consult advisers when there is a problem. "It could be a specific tax problem, something quite minor. Or it could be something larger if they are very busy," she says.

Options

Despite the value advisers can add, companies are eager to maintain control of their processes through the downturn. Tax directors fear they could lose a certain competency altogether if it is outsourced.

Adam Little, corporate tax director at Petro Canada, says dividing the people doing the advisory work from the people doing the compliance work increases the risk of mistakes and inefficiencies, especially in smaller organisations.

An initiative Eberle has witnessed in this recession is groups recruiting temporary consultants. "They may hire someone for 30 hours a week for eight weeks for example, just to get them through their compliance type burdens," he says. The alternative is borrowing staff from a consultancy to work in-house for a certain period of time. But Eberle says the accounting firms tend to send junior staff with only one or two years experience. "Temporary workers are often public accountants with six or seven years experience who took some time off to start a family for example and are ready to take on some part-time work," he says.

The level of control a tax director likes to have over functions varies in every company and for every individual. Co-sourcing, where only part of a function is externalised, is an option which allows business to retain some level of control. "It's a combination of outsourcing and in-sourcing," says Wiggins. "There's always a spectrum," he adds. "You can't outsource everything. You need control over certain aspects."

The culture of the company can determine whether or not outsourcing is the best option. Sometimes it is a case of trial and error. Murphy, for example, outsourced his transfer pricing documentation to an auditing firm. But it turned out their knowledge of the group was not sufficient so he took it back in-house. "It was too complex to outsource," he says. "Every time there was a restructure it affected transfer pricing."

A group's size can also be a deciding factor. Disney's Asia Pacific tax team is a lean operation. It is just Yuen and one other colleague. "I am not a TP expert," Yuen says, so he outsources all his transfer pricing obliga-

GE's approach

GE has come up with an innovative way to overcome outsourcing concerns. The organisation has a 19-person team in India that supports its global tax organisation by preparing transfer pricing documentation. It is not outsourcing in the traditional sense as the team members are GE employees. Peter Barnes, international tax counsel at GE, calls it their centre of excellence for transfer pricing.

"The team is closely connected with the GE businesses," he says. It prepares a functional analysis for each entity, conducts the necessary comparables searches, and writes the reports. The team in India was formed in 2003 with six people and has grown steadily. In 2008 it prepared about 850 transfer pricing reports for GE businesses in 40 countries.

Barnes is pleased with this arrangement. "The team is knowledgeable about the GE businesses and how they operate. It also has a deep knowledge of each country's transfer pricing rules because it is closely connected to the GE tax teams in each of the 30 countries or so where we have local tax groups," he says. "The team ensures that we have high quality, consistent transfer pricing documentation to meet the requirements of the various national laws," Barnes adds.

tions. But he is still very involved in the group's transfer pricing as it is an important function. "We use TP as a shield and a sword and actively manage our royalty rates," he says. He works closely with his advisers to make sure they get all the relevant information and he reviews draft reports. "I'm very hands-on," he says.

Some tax directors consider this a disadvantage of outsourcing. "To ensure efficiency, outsource performance still needs close and effective monitoring, which reduces any resource saving," says Little.

Murphy says it is difficult to get continuity and good industry knowledge from service providers. "It's difficult for people coming in to do work who don't have specific company knowledge," he says. "They want to set up interviews to find out who the major players are. This is a waste of everyone's time. Information gathering is a major problem with outsourcing."

Working as a team

Bringing in external advisers can result in a leaner, more competent tax department. Some times it takes a third party to assess internal processes and suggest improve-

ments. Before advisers begin working with a group, they encourage the tax director to look at the team's processes to make sure they are as efficient as possible so they get the most out of the outsourcing. This could result in freeing up resources which could be moved to more strategic jobs.

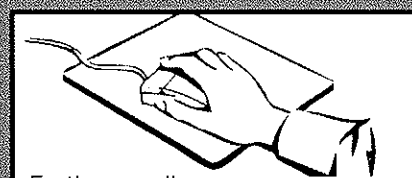
But external advisers cannot fix inherent problems. "There's a misconception that outsourcing is an easy option, that you're giving the problem to someone else," says Richard Chadwick from PricewaterhouseCoopers.

"But if there are problems with information flows, accessing data, or poor documentation, then even if you outsource, the problems will still be there," he says. Tax directors have to weigh up the pros and cons of outsourcing work. If they decide it is the best course of action during the downturn, they have to convince their bosses. "Sometimes, my job feels like a broker," says Yuen, "having to justify costs of external firms."

One benefit of outsourcing that tax directors and their superiors can not overlook is that advisers have inside access to the market. The service providers see and drive developments and companies can find out what their peers are doing through conversations with them. "You need interaction with players in the industry," says Murphy, "otherwise you get cut off."

In uncertain economic times, keeping on top of what your competitors are doing is essential. There is no better way of finding out what other companies are up to than from the people helping them to implement their processes and make their decisions.

Working with external advisers can encourage new ideas which can position companies better in the recession. Persuading tax directors of this is one challenge for advisory firms. Convincing management is a harder job.



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