

Tax Technologies, Inc.

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This newsletter is from JD Choi of Tax Technologies, Inc. to tax professionals whose interests include improving the tax management processes.

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- **How to Get Form 5471 Prepared for \$360 per Entity**

In this article you will see how you can reduce labor costs related to Form 5471 compliance to \$360 per entity by means of optimal task allocation between an in-house resource and offshore resource.

- **How to Reduce Tax Software Licensing Cost by 50 Percent**

TTI introduces a program that will reduce corporate software licensing costs by 50 percent.

How to Get Form 5471 Prepared for \$360 per Entity

With the global recession in full force, companies are taking measures to cut costs. Tax departments are not exempt from this cost reduction. TTI has been providing solutions to significantly reduce compliance costs for the past 9 years. Utilizing that experience, we have identified ways to reduce the overall compliance cost.

Compliance costs consist of three main components for most companies - **labor, software licensing, and internal IT expenses**. The information below analyzes how companies can reduce these costs without sacrificing the quality or processing efficiency.

LABOR

Due to the current state of the global economy, many corporate tax departments are being required to reduce their tax staff. Ultimately, this means that the remaining tax staff will have to work substantially harder in order to compensate for the loss of team members because the workload remains the same. In fact, the current administration is likely to require additional reporting as it implements more regulations, which means that it has become imperative for tax management teams to find ways to reduce costs while sustaining output, if not increasing it, compared to prior years. The solution is

rather simple: **Allocate non-value added data processing to a low labor cost location and retain high value work in-house.** With this approach, companies can prepare Form 5471 for \$360 per entity. Proof of this analysis is documented below.

In-house Resource Costs

One in-house U.S. international tax staff with 2 to 4 years of experience may cost \$100,000 to \$150,000 (\$60,000 to \$90,000 annual salary, benefits, and other corporate charges). Most tax departments also have corporate tax managers reviewing the returns. Annual compensation for tax managers can range between \$150,000 and \$200,000.

Using a professional accounting firm as a model for cost allocation, a staff level accountant may have anywhere between 1,000 and 1,500 of client chargeable hours per year. If we assume that translates to approximately 1,250 non-administrative hours for an employee, the cost per hour becomes \$80 to \$120 for in-house tax staff and \$120 to \$160 for tax managers. Based on this breakdown, two hours of staff time and one hour of manager time would consume approximately \$360 of budget resources for the return preparation.

Although it is not impossible to prepare the return (for example one Form 5471) in three hours, it is not feasible to complete the returns consistently under three hours. In reality, preparation of Form 5471 may take approximately 8 to 12 hours for a return of medium complexity (10 hours on average). Based on this estimate, completing each Form 5471 would cost approximately \$1,200 to \$1,500 if done efficiently.

Because it is not possible to lower the number of hours to prepare each Form 5471, the labor cost per hour must be reduced to lower the total cost of preparing the tax returns. (See the table below for details of the processes required for the completion of Form 5471.) Taking this into consideration, *the only effective way to lower the cost of preparing tax returns is to allocate non-critical tasks to low-cost resources such as interns or overseas staff.* Though this approach may be politically unpopular, it remains one of the few ways companies can meet the demands of reporting requirements while cutting costs.

The following information outlines how tasks can be effectively allocated to low labor cost countries such as India to reduce the overall cost of tax return preparation. Please note, **I advocate the "allocation of tasks" rather than the "outsourcing" of returns.** This distinction must be made as many companies have attempted to "outsource" their return preparation in an effort to reduce costs and failed.

Effective Allocation of Tasks

Conventional wisdom is that approximately 80 percent of tax compliance work is data processing and the remaining 20 percent is the actual tax analysis. I personally agree

with that approximation. While working with clients, we have been able to identify every task that needs to be completed for the tax returns. Once identified, we then categorized each task based on whether the task required tax expertise or it is a simple data processing task.

The following table provides an example of a simplified analysis of international tax compliance requiring preparation of Forms 5471 and 8858. This analysis indicates whether a specific task is a "data processing" or "tax analysis" task. Once we complete such an analysis, we can then allocate the data processing tasks to a low-cost jurisdiction while allocating tasks that require professional tax analysis to one of our various levels of in-house resources.

Task Description	Requires Tax Expertise	Data Processing
Prior year form rollover to current year		Yes
Validation of rollover data on forms	Yes	Yes
Current year tax return software set up		Yes
Current year entity maintenance	Yes	Yes
Trial balance preparation (download from GL)		Yes
Trial balance import (reformatting, etc.)		Yes
Trial balance validation		Yes
Trial balance reconciliation to financial system		Yes
Reclassification of accounts for bad accounting	Yes	Yes
Data collection package preparation	Yes	Yes
Data collection process management		Yes
Data review on packages received	Yes	Yes
Correspondence with local controllers	Yes	
Process data from data collection to returns		Yes
Adjustment analysis	Yes	
Review of current year E&P based on adjustments		Yes
Intercompany transaction matching		Yes
Intracompany elimination		Yes
Section 987 gains and losses	Yes	
Sourcing analysis	Yes	
Review of Subpart F income	Yes	
Dividend analysis	Yes	
Section 956 analysis	Yes	
Form processing		Yes
Statements and attachments	Yes	Yes
Workpaper support documentation		Yes
E-filing diagnostics		Yes
E-filing corrections		Yes

Task Description	Requires Tax Expertise	Data Processing
Transmission file content review		Yes
Task count	13	22
Task Percentage	37%	63%

As the example shows, even without assigning weights to each of the tasks, over 60 percent of the international tax compliance tasks are data processing as opposed to substantive tax analysis.

Given the composition of the tasks, the 10 hours of estimated average preparation labor to complete a tax return can be allocated as follows:

- In-house resource: 2 hours at \$100 per hour = \$200
- Offshore resource: 8 hours at \$20 per hour = \$160
- Total cost per return using the cost allocation = \$360

This is how a company can produce a return for \$360 per entity.

Clearly companies may not allocate the tasks in the way presented without substantially altering their current processes. Therefore, the next question is "What would it cost to get the tasks allocated to achieve the end goal of reducing the compliance cost?"

Ways to Get to Cost Allocation

In order to achieve the overall goal of reducing tax compliance costs by way of task allocation rather than outsourcing, three key components must be considered. First, **constant contact between in-house resources and offshore resources to move the tax return process efficiently without adding an additional layer of administration** is of utmost importance. Secondly, the **offshore resources must be as competent as the staff level of the in-house resources** to avoid a long learning curve and unnecessary mistakes. Lastly, **the communication skills of the offshore resources must be at an adequate level to communicate effectively.**

In order to maintain constant contact between the in-house staff and offshore staff, **companies must have tools that can facilitate such communication and collaboration.** This can be achieved using Web-based software that facilitates integration (such as data collection, task tracking, compliance computation, data sharing, legal entity maintenance, form production, e-filing, and so forth).

Do not "Outsource"

In an attempt to quickly reap the benefit of low-offshore labor, companies outsource tax return processes (and other processes such as tax provision reporting) to offshore resources. I firmly believe that outsourcing to minimize U.S. staff is ineffective in most cases. Companies must maintain an adequate level of U.S. resources to facilitate, review, and maintain the continuity of knowledge in-house to effectively reduce overall cost of tax administration.

Many tax administrative processes are interdependent. The tax return process is dependent on the provision process; the audit process is dependent on the tax return and related documentation; and the planning process is dependent on the provision and return process. Thus, maintaining in-house resources to maintain institutional knowledge is critical in making all of the tax administrative processes work seamlessly. When a tax process is outsourced, institutional knowledge is very difficult to maintain in-house and it is not cost-effective.

SOFTWARE LICENSE

The tax software license cost can be a significant component of the compliance cost as it can range from a few thousand dollars to over a million dollars depending on a variety of factors. In general, non-incumbent tax software vendors will provide a better price if a company has been using the same software for a long time. This is because most of the incumbent software vendors have been raising the price based on fixed percentages over the years. Thus, often times, companies that have used the same software for long time end up paying more than companies that have used the same software for a shorter period of time.

Although the software licensing cost can be significantly lowered by changing software vendors, companies are reluctant to make such a change. This is primarily due to the other costs associated with switching vendors such as data conversion and software training fees. Thus, when companies consider lowering their software licensing costs, they must take into account the data conversion, training, and change management costs.

In most cases, the cost related to changing tax compliance software is a onetime charge while the high licensing cost is a recurring charge. This means that when considering making a change, companies should evaluate the reduction of licensing costs on an annual basis, the one-time conversion cost of switching software, and the added benefit of new software.

Small companies may find it easier to convert to new software as the cost of conversion can be minimal. For example, companies with less than 30 entities globally with few participants in the compliance process should be able to convert to new software within a couple of weeks with almost no additional cost to the company as the new vendor is likely to provide conversion cost as part of the licensing.

Medium size companies (30 to 100 entities) may have to pay a conversion cost. In order to produce a higher level of efficiency, companies may consider a Best Practice implementation rather than a simple conversion. Further, as the companies have more participants in the tax processes, it requires more coordination throughout the conversion process. Such companies should also be able to get the data conversion completed within a couple of weeks.

Large companies will require a significant level of planning, not necessarily because their data conversion is complex, but because of the user factor. Usually, data conversion does not take more time simply because of the number of entities. It may take more time to diagnose errors in the data if several errors exist. In reality, it takes a lot more effort to change a large number of users' interaction with tax software than converting the data. Imagine changing over 1,000 individuals' behavior around the world. It takes a substantial amount of work to get them all changed.

The benefit for larger companies, however, can be enormous. Imagine the benefit of having over 1,000 people around the world working together efficiently. Simply put, every two hours saved in each tax processing cycle can result in one full-time employee savings equivalent for the company. The increased efficiency can easily pay for the entire cost of conversion within the first year of conversion.

We have implemented Tax Series globally to produce such a benefit. As the same process is used at least six times a year (quarterly processes, annual process, and extension process), the benefit of the conversion and implementation compounds every time this enhanced process is used.

INTERNAL IT EXPENSES

In large part, IT charges can be avoided if companies choose to use an application service provider (ASP) solution. Simply put, if the tax department uses Web-based software, most of the interaction between the IT and tax department can be avoided. At the same time, specific changes for the tax department (such as server charges, service charges to manage the software installation, data management charges, and support charges) can be avoided because the tax department no longer has to rely on the IT department to manage the servers for tax software.

Given that most of the tax software vendors that are providing ASP services understand the specific demands of tax departments, they can be far more responsive than most in-house IT resources. Also, tax software vendors can share the cost across many user companies by bundling IT charges as part of the licensing fee. Thus, a large part of cost relating to the internal IT changes can be reduced if a company decides to move to an ASP rather than in-house installed software.

In conclusion, labor cost can be significantly reduced through offshore task allocation; software licensing cost can be reduced by switching to a non-incumbent vendor who is more willing to provide a lower price; and internal IT cost can be eliminated through the use of ASP solutions.

I believe that companies will continue to reduce the cost of tax administration even if the economy turns around. Of all these changes, management's willingness to take the necessary steps to adopt the change is the key factor in achieving the cost reduction.

Under recessionary economic conditions, no good choices are left. Inaction by management will only worsen the situation.

Reduce Tax Software Licensing Costs by 50 Percent

There are five main vendors that provide corporate compliance software - RIA, CORPTax, Vertex, Tax Dimensions, and Tax Technologies, Inc.. Companies have been complaining that the tax software licensing costs have been getting too expensive. In many ways, the pricing strategies have been very similar across all vendors. They were based mainly on modules, entity counts, and user counts. In addition, there have been some unexplainable charges.

In response to such complaints, **TTI has decided to offer a 50 percent reduction program. Under the terms of this program, if your company is using one of the four other major vendor's software, we will give you a 50 percent reduction for comparable modules of Tax Series.** Simply provide us the last invoice showing the details of the modules used, number of entities, and number of users. If our standard price is not already less than 50 percent of your existing licensing cost, we will reduce it to 50 percent of your existing licensing cost and lock that price in under at a least three year contract.

If you are interested in this program, contact us at <http://www.taxtechnologies.com/Contact.aspx>.

At the same time, TTI is known for its excellent support. All client support is handled by our U.S. tax staff, which is knowledgeable in U.S. taxation as well as Tax Series. Our standard support and training is included in the licensing fee even if your company participates in this 50 percent reduction program.

Tax Technologies Institute Training Schedule:

During the remainder of 2009, the Tax Technologies Institute will offer **FAS 109 – Tax Accounting Basics**, a 2-day Best Practices hands-on training course on the following dates:

- April 20-21

- May 18-19
- June 22-23
- July 27-28

Also during the remainder of 2009, the Tax Technologies Institute will offer **International Compliance Basics**, a 2-day Best Practices hands-on training course on the following dates:

- April 23-24
- May 28-29
- June 22-23
- July 30-31

The Tax Technology Institute is located at 336 West 37th Street between 8th and 9th Avenues in New York City. Although TTI provides computers for use in hands-on training, participants are encouraged to bring their own laptops with their own data.

As part of our comprehensive business solutions offerings to our clients, we also provide unlimited training at no cost to Tax Series users.

Click the following hyperlink for details related to the training courses:

<http://www.taxtechnologies.com/training/default.aspx>

Training from the Tax Technologies Institute is designed to help maximize the productivity, efficiency, and effectiveness of corporate tax resources.

About Tax Technologies, Inc.

Tax Technologies, Inc. produces industry leading corporate income tax compliance and provision software as well as offers related services. Please visit <http://www.taxtechnologies.com> and learn more about our software solutions and services."

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