Making tax lean

Professional standards



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Lucy Jones provides guidance on how Lean efficiency philosophies can be applied to tax models

Key Points

What is the issue?

With the ever-increasing tax requirements in the UK, taxpayers need to plan how they will manage their resource and costs to remain compliant.

What does it mean to me?

While taxpayers may have already considered the benefits of technology and outsourcing, reviewing tax processes with a Lean approach can identify long-term cost-effective ways to cut down on the work required as well as improving quality and risk.

What can I take away?

Challenging the current methods for the most consuming processes should provide capacity for advising on more complex matters and satisfying stakeholder needs.

Taiichi Ohno at Toyota Motor Corporation developed Lean philosophy in the 1930s with the renowned Toyota Production system. In the automotive industry, rather than position themselves at the forefront of technology, Toyota's success has come from producing high quality, reliable cars in an efficient and effective manner that takes less time and money. Over the years, the philosophy has spread across the world and to other businesses where in particular it has been used for Just-In-Time manufacturing. However, the same principles can be applied to almost any business area and the potential in tax is undoubtedly worth considering.

In basic terms, Lean philosophy aims to design and then continuously improve processes that minimise waste, increase flow and focus attention to add value to clients. The benefits of this are the reduced cost to the business, reduced lead times, and increased quality and flexibility.

Over recent years, we have seen a number of new requirements in the UK tax sphere, in the areas of technology and governance, which make the benefits of Lean appetising for business tax processes.

Firstly, Making Tax Digital will go live for VAT on 1 April 2019, with other taxes such as income tax and potentially corporation tax expected to follow later (initially aimed for 2020 however a delay has been confirmed to focus HMRC IT resource on Brexit implications). To date the UK government has been slower to introduce such advances compared with other European jurisdictions; already seven countries have implemented an xml Standard Audit File for Tax (SAF-T) mainly based on OECD guidelines. In Poland, the monthly submission of the VAT SAF-T file replaces the monthly VAT return from 1 January 2019. As HMRC have stated their objective to be

the most technologically advanced tax authority in the world, following Brexit further consultations could be seen for their plans to complete MTD across taxes and further harness technology to make the UK tax system more efficient, effective and easier for taxpayers to get their tax right. Secondly, since Senior Accounting Officer legislation was enacted 10 years ago, governance and risk responsibilities have ramped up even more with Tax Strategy publication, Corporate Criminal Offence and Diverted Profits Tax. These are complex areas that need considerable thought and planning to protect the business and so more tax advisory time and fees should be dedicated to these areas that were previously allocated to compliance.

To date, many companies have looked to new technology offerings to deal with MTD and Excel expertise to control the workload involved in the tax compliance cycle. Large accounting and tax firms have also used centralisation of compliance and even outsourcing to countries with cheap labour to focus their local professionals on technical, customer-centric work.

However, the benefit of technology can be limited by the quality of the source data and can also prove expensive, while outsourcing still requires funding and management time. With this in mind, tax advisers can work with their clients, following Lean thinking, to get the information right first time and eliminate much of the work that would otherwise be automated or outsourced. As corporation tax in particular can be a lengthy and labour-intensive process in the run up to the filing deadline 12 months after year-end, let us consider here the application of Lean in terms of the corporation tax compliance process, although the principles can equally be applied to a range of tax submissions.

The Lean approach specifies that the areas of adding value in a process be only the elements of the work that are important for the customer deliverable and generally, that they would be willing to pay for. While HMRC do not pay for the tax work, HMRC receive the final output and so we should consider the process from their perspective to allow us to identify the waste.

The added value in a CT compliance process is determining and entering the accounting and tax adjustment data into the computation and return. The work involved to get to this point is non-value added or business value added (required for audit trail, regulations etc.) but does not change the output/submission to HMRC. The aim would then be to reduce the non-value added steps in the process, and identify opportunities to build in further quality. Secondly, HMRC requires robust

controls and a Lean review of the processes drives a tightening of those already established leaving the company in a stronger position.

In an ideal world, the remainder of the work would not be necessary. As such, we can imagine an ideal state of the process being that all items to be reported on the computation and return are readily available as soon as the financial statements are signed. These would be available in a single report in the accounting system and the tax return would be automatically populated from it. This dream vision/ideal state can be kept at the back of our mind when we consider improvements along the way that should be aimed at getting closer and closer to this.

Identifying the waste (‘Muda’), overburden (‘Muri’) and unevenness (‘Mura’) in a process is the first point of consideration. The types of waste to pinpoint are the following: Transport, Inventory, Movement, Waiting, Over processing, Overproduction, Defects, and Intellect (which can be remembered with the acronym TIMWOODI). The Lean philosophy encourages ‘walking the Gemba’ to see what happens in the process first hand and enable management to see for themselves the wastes involved.

In CT compliance, there will likely be various wastes in a Fat Tax Plc (‘FTP’) such as the following:

- Intellect (tax professionals analysing expenditure breakdowns where the rules are fairly simple),
- Waiting (for statutory financials, or breakdowns of various expenditure),
- Defects (with analysis prepared by someone removed from the business activity),
- Over-processing (reworking data that has already been entered into the accounting system for tax treatment, or even that has already been analysed by accountants unbeknownst to the tax adviser and so the effort is duplicated).

There are also likely to be overburdened accountants and tax advisers at various stages and unevenness due to data not being available at the right time (as with Just in Time production).

Armed with this awareness, FTP would undertake further detailed planning:

- Record the timings along the current process to the time worked at each stage, the cycle time (time at a particular stage including wait time) and total lead-

time to filing.
- Diagrammatically map out the whole process and annotate with key times recorded above and personnel.
- Review the process map with times and circle blocks in the flow such as cycle times much longer than other steps (for good flow, ideally the cycle times would be equal across the process); long waiting periods; or more work performed. The blocks are where there are opportunities for improvement.
- Pareto's law states that 80% of the effects come from 20% of the causes. A graphic of cycle times can then visually demonstrate the few steps in the process that result in 80% of the time and work invested and reinforce the areas of greatest opportunity.

For example, a corporation tax return for FTP might be submitted during December, with work having commenced after the June signing of the financial statements. The largest cycle time may have been the two months to review P&L expenses to quantify disallowable entertaining. Ways to bring the start date forward and reducing the time on entertainment adjustment would then be worth investigating further.

Root cause analyses will allow a fundamental, long term and effective solution to these focus areas. To quote author Anthony J. D'Angelo: 'When solving problems, dig at the roots instead of just hacking at the leaves.' And so, by investing time determining the underlying reason for pain points arising in the first place, a cheaper and more effective solution is more likely. A small change at the start can have a snowball effect and prevent larger scale errors downstream, as turning off a tap prevents its flooding.

There are various methods that can be utilised for root cause analysis and these can be most effective when used together. One such method is brainstorming, which enables a group of people that have sound knowledge of the process and can bounce ideas of each other. In addition, a '5 whys' exercise involving the reviewer asking why the issue has occurred in five iterations to drill down to the underlying root cause can be very powerful. This can be conducted for several potential contributing factors in a tree diagram that allows various pain points to be explored.

With root causes known, precise brainstorming targets addressing these root problems as early as possible in the process. Prioritisation by evaluating such ideas based on their expected gain versus anticipated effort levels will clarify which should

be trialled in a first test. It can then be seen how the flow and metrics have improved from the previous state.

For FTP’s non-deductible entertaining, it might be that guidelines could assist with the accountant or business users to select a non-deductible general ledger account or adding more information into accounting software to drive the tax treatment. A radical change in the accounting software might be high effort/cost and not implemented initially, however guidelines for GL use would be low effort to trial in the first instance. With a few trials under the belt, submission date could be down to June, with half the time spent by tax advisers and accountant.

After first test, reflect and check the progress made from the past. What more can be done? What are the areas to improve on the current state in the new process map and times? A scientific trial and error approach amongst various stages, with a few prioritised changes made at each point will drive the process nearer and nearer the ideal state.

In years to come, a Lean approach will optimise processes that can be later automated with innovations in technology. Together they will enable businesses to strengthen their tax compliance controls and increase comfort levels as well as focus their tax advisory resource on the areas that matter for their commercial and business goals.