Navigating the quagmire

Complex tax regulations call for increased planning

By Sujata Srinivasan

Corporate tax departments should focus on e-filing, consider tax co-sourcing, embrace information technology and stay abreast of new tax developments as they continue to plan for the current year in a highly regulated environment, according to KPMG LLP, a tax and audit firm with Connecticut offices in Hartford and Stamford.

"Increased documentation requirements, complex internal reporting and data conversion processes, and the ever-increasing filing requirements are just a few of the pressures affecting day-to-day performance and shaping the compliance efforts of tax departments everywhere," says Thomas Garigliano, a partner in KPMG's tax practice. "With that in mind, now is the time for tax departments to start taking steps to increase efficiency and streamline processes in 2006."

Effective this year, corporations with assets of $50 million or more who file at least 250 returns such as 1099s (where the employee's salary is paid on an untaxed basis and it is the individual's responsibility to file and pay the appropriate state and federal taxes) and W2s (where the employer withholds and pays all of the employee's taxes) are required by the IRS to file their annual income tax returns electronically.

"This is not going to be a big deal for companies that use large, national and well-known software firms to produce their tax returns," says Alex Discepolo, director of lead tax services at Deloitte Tax LLP, a Hartford-based tax and audit firm. "However, smaller companies who are preparing their tax returns in-house will have significant issues in the first year due to lack of resources and expertise."

He says Deloitte's internal costs are also expected to rise this year, since tax firms are no longer allowed by the IRS to create supporting schedules outside of the primary tax software. This, in turn, is expected to drive up Deloitte's client fees for filing tax returns by 10 to 30 percent this year.

Discepolo notes that several of his clients, including mid-sized technology companies in Connecticut, are grappling with implementing changes under the Sarbanes-Oxley (SOX) Act of 2002 governing publicly traded companies.

"SOX compliance is draining their resources – information technology, accounting and personnel – and it's really hurting these companies," he says. "There are many technology companies regretting the day they went public."

Under the Act, the auditing firm can no longer provide business advisory services, such as guidance on internal controls, to the same publicly traded client company due to conflict of interest issues. So the Big Four [KMPG, Deloitte, PricewaterhouseCoopers and Ernst & Young] swap auditing and business advisory services with one another. "It's a sort of shifting of services," Discepolo explains.

Charles Frago, tax managing director at KPMG LLP in Hartford, observes that smaller companies impacted by SOX are outsourcing their tax provision expense calculation function. A KMPG survey revealed that 62 percent of tax executives expect to co-source some of their tax-related functions over the current year.

"Co-sourcing is different from outsourcing," Frago says. "It's when you're working in tandem with another company. For example, some of our clients may not have significant expertise in doing the tax provision, so they may co-source parts of it to us. But they maintain the overall management of the product as required under SOX regulations." Co-sourcing also helps reduce human resource costs, he adds.

Frago points out that while companies are very focused on the federal tax rules, they sometimes put state taxes on the back burner. A lot of the federal tax incentives help reduce their federal tax bills but some states, due to budgetary difficulties, do not follow the federal rules and that could sometimes creep up on companies that are not following the state laws closely. "That's something that companies must focus on this year," he cautions. ■