

# **Automating Sales and Use Tax Compliance**

Making Sense of a Complex Regulatory Environment

February 2014

Nick Castellina

February 2014

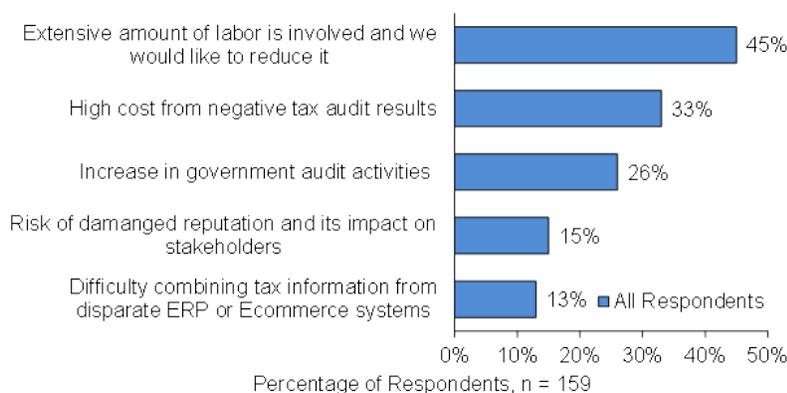
## Automating Sales and Use Tax Compliance: Making Sense of a Complex Regulatory Environment

Of all of the processes affected by a changing business environment where organizations are more frequently selling products over the internet, indirect tax compliance may be the one that provides employees with the most uncertainty. The [Marketplace Fairness Act](#), which Aberdeen finds 30% of organizations are subject to, and “Amazon” laws (34%), will require organizations to collect sales tax at the point of sale in geographies that they have previously not required compliance. Even for those organizations not impacted by the changes in Ecommerce, a dynamic regulatory environment, with rapidly changing laws, makes tax managers’ lives difficult. How are they to stay on top of new mandates across wide geographic networks, complete tasks quickly, and report accordingly with limited staffs and access to readily available tax law documentation? Only by making sales and use tax compliance as easy as possible can organizations avoid fines and keep costs low in the back office. This report, based on a survey of 159 organizations, outlines best practices for sales and use tax automation.

### The New Tax Environment

Aberdeen’s [Indirect Tax Automation survey](#) identified the top business drivers that encourage organizations to scrutinize their tax management initiatives (Figure 1).

Figure 1: Business Drivers Impacting Tax Management



Source: Aberdeen Group, November 2013

### Analyst Insight

Aberdeen’s Insights provide the analyst’s perspective on the research as drawn from an aggregated view of research surveys, interviews, and data analysis.

### Aberdeen Methodology

The Aberdeen maturity class is comprised of three groups of survey respondents. Classified by their self-reported performance across several key metrics, each respondent falls into one of three categories:

- ✓ **Best-in-Class:** Top 20% of respondents based on performance
- ✓ **Industry Average:** Middle 50% of respondents based on performance
- ✓ **Laggard:** Bottom 30% of respondents based on performance

Sometimes we refer to a fourth category, **All Others**, which is Industry Average and Laggard combined.

Top of mind for tax managers is the difficulty in actually doing their job. Forty-five percent (45%) noted that they would like to reduce the amount of labor involved in managing sales and use tax. Understanding the differing tax laws in the geographies that the organization has an established nexus in, collecting and remitting taxes, and reporting effectively are time consuming, complex, and prone to mistakes. This is compounded in organizations where technology and processes are not aligned effectively. Thirteen percent (13%) noted a difficulty in combining tax information between multiple systems. Often, organizations use multiple systems to complete these tasks. These pressures call for better automation and integration.

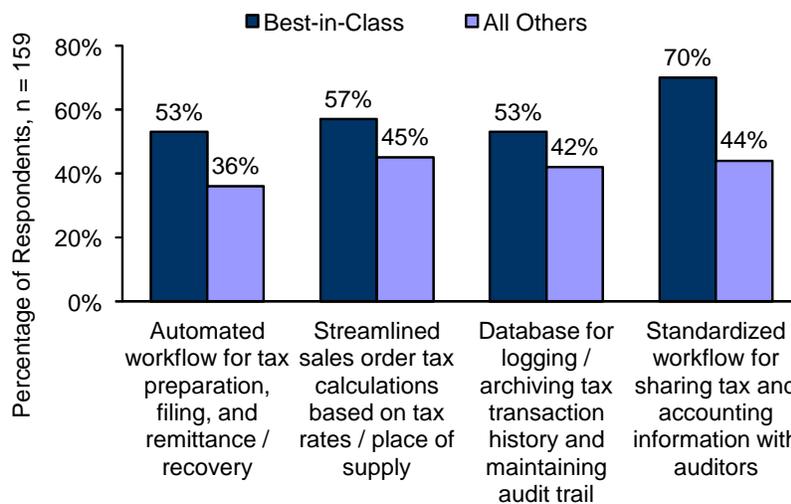
The other top pressures concern increased audits and their potential impact. As state governments continue to experience cash constraints, tax audits become an attractive source of income. Note that 26% indicate an increase in audit activities. Audits can result in fines and reputation damage. These pressures call for a proactive approach to prepare for potential audits.

Combined, these business drivers lead Best-in-Class organizations to alter the ways they have dealt with sales and use tax in the past. Just as business models have changed, so have the back-office processes that support them. What follows is a guide for effective sales and use tax management.

## An Automated Approach to Sales and Use Tax

By automating sales and use tax management, organizations can avoid mistakes, improve efficiency, and avoid the costs of negative audits (Figure 2).

**Figure 2: Facilitating Tax Management**



Source: Aberdeen Group, November 2013

Best-in-Class organizations are 47% more likely than All Others to have automated workflows for tax preparation, filing, and remittance / recovery.

### How Do You Rate?

Survey respondents from Aberdeen's [Indirect Tax Automation survey](#) were ranked on the following criteria:

- √ **Percentage of positive audits over the past 5 years:**  
Best-in-Class – 91%,  
Industry Average – 61%,  
Laggard – 60%
- √ **Overpayment occurrences out of all audits performed over the past five years:**  
Best-in-Class – 2%,  
Industry Average – 3%,  
Laggard – 18%
- √ **Percentage change in the time it takes to address tax errors over past two years:**  
Best-in-Class – 27% decrease,  
Industry Average – 7% increase,  
Laggard – 49% increase

Every step of the process is guided through technology, enabling employees that may not necessarily be familiar with all the new requirements to complete tasks without mistakes. It also enables the department to complete tasks more quickly because there are fewer questions and handoffs are handled immediately. For example, 57% of the Best-in-Class have streamlined sales order tax calculation. Formulas are provided to employees that ensure correct calculations, no matter where the sale is made.

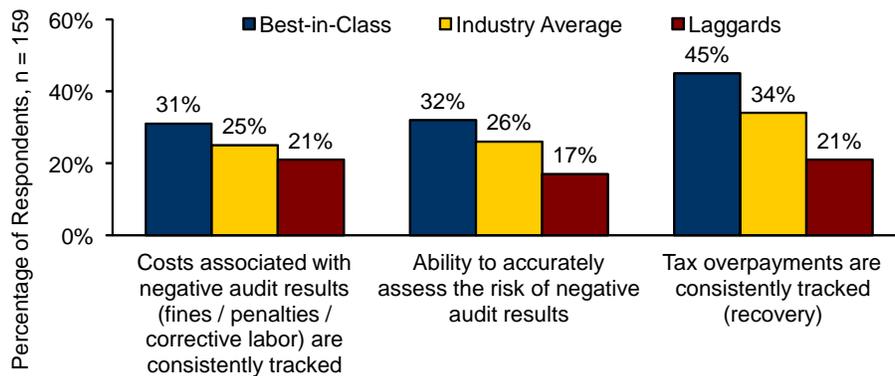
Automation also helps prepare for and complete report filings and audits. An automated record will ease the impact of audits on daily operations. Fifty-three percent (53%) of the Best-in-Class have a centralized database for maintaining an audit trail. This data is then automatically shared with technology-guided standardized workflows. The Best-in-Class are 59% more likely than All Others to have a streamlined process for sharing tax and accounting information with auditors.

While automation greatly aids tax compliance as individual processes are completed, it must be remembered that compliance is an ongoing process, and there is always the potential for errors. Measuring and tracking the impact of noncompliance and mistakes will enable organizations to alter their processes while ensuring that they do not overpay or experience audits. The Best-in-Class do a better job of keeping track of the data that will promote compliance going forward (Figure 3).

**Fast Fact**

√ Forty-eight percent (48%) of the Best-in-Class have automated and periodic updates of tax rates and laws, in comparison to 39% of All Others.

**Figure 3: Keeping Track of Compliance**

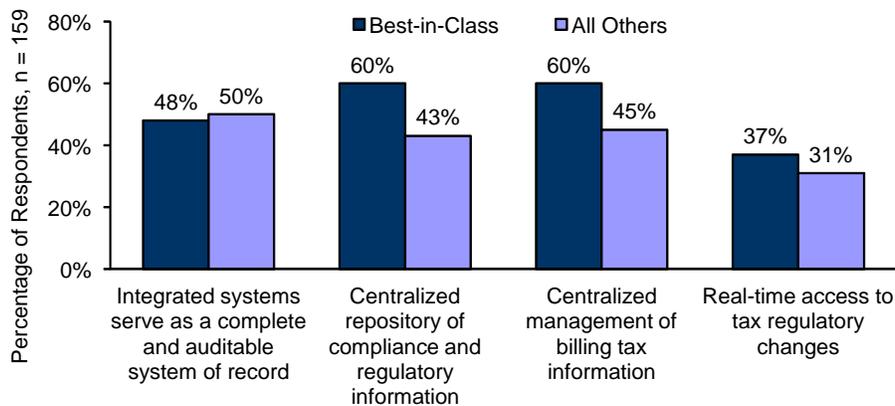


Source: Aberdeen Group, November 2013

For example, the Best-in-Class are more likely than All Others to track the costs associated with negative audit results, as well as assess the potential risk of receiving those results. This data will provide top level decision-makers with a concrete reason to fund improvements to tax management. Additionally, the Best-in-Class are 50% more likely than All Others to track tax overpayments. With widely varied tax laws, mistakes can happen. Tracking this information ensures that the organization is able to recover overpayments, which can be substantial.

How does an organization begin to provide an environment that supports efficiency, effectiveness, and transparency in sales and use tax management? It can be accomplished by providing a single, central source through technology (Figure 4).

**Figure 4: One Centralized Source**



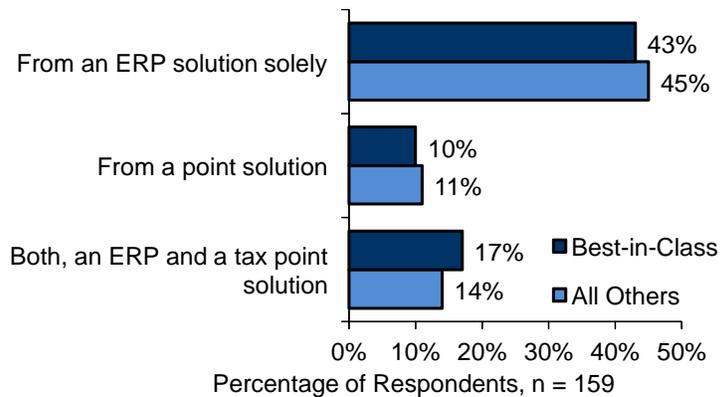
Source: Aberdeen Group, November 2013

First of all, the necessary information that is utilized in taxing, remitting, filing, and recovering may be contained in different systems. This may not be ideal. Therefore, these systems must be integrated effectively. Data should be easily shared and employees should not be too conscious that they are working across multiple applications. Half of all respondents have integrated business solutions that serve as a complete and auditable system. The Best-in-Class do a better job of centralizing this system as the one true source, enabling employees to go to one place for all the data they need. Sixty percent (60%) of the Best-in-Class have a centralized source for compliance and regulatory information. And this information does not need to be only internal. With fluid tax laws, information needs to be available so that employees can understand rates and rules, as well as constantly updated because these regulations change so frequently. Sixty percent (60%) of the Best-in-Class have centralized management of billing tax information, and 37% have real-time access to tax regulatory changes.

### **Essential Technology**

So how do Best-in-Class organizations enable an environment that best supports tax management initiatives? There are several options, with most organizations choosing to manage tax with their Enterprise Resource Planning (ERP) solution alone (Figure 5). But Best-in-Class organizations are actually less likely than All Others to take this approach. There are many point solutions that contain functionality specifically designed to support different aspects of tax management. Still, much of the necessary data is contained within ERP. This is why the Best-in-Class are more likely than All Others to pair their ERP data with a point solution designed for tax. This will enable the complete system of record that was referenced above.

**Figure 5: Technology Used for Managing Tax**



Source: Aberdeen Group, November 2013

These point solutions perform a variety of utilities that are essential for sales and use tax in the new environment. Note that Best-in-Class organizations are more likely to have implemented these solutions across the board (Table I). For example, the Best-in-Class are 19% more likely than All Others to have tax rate calculation solutions. This will enable them to automatically calculate and collect the correct amount of tax on sales, regardless of the location. These tools can then automate the rest of the process. Fifty percent (50%) of the Best-in-Class have tax preparation and filing solutions. The Best-in-Class are 43% more likely than All Others to have remittance tools. The point being that these solutions can sit on top of ERP in order to automate complicated processes (utilizing ERP and other data), and promote efficiency and effectiveness.

**Table I: Key Enablers of the Best-in-Class**

	Best-in-Class	All Others
Tax rate calculation solutions	57%	48%
Audit control solutions	57%	29%
Tax preparation and filing solutions	50%	43%
Tax remittance tools	46%	32%
Fraud management solutions	43%	23%
Registration / taxability evaluation tools	42%	18%
Tax exemption / exception management	37%	27%
Tax recovery solutions	32%	25%

Source: Aberdeen Group, November 2013

## Key Takeaways and Recommendations

Tax management is an extremely important, but complicated process. Effective sales and use tax management requires understanding

geographically varied laws, tax collection, reporting, remittance, and recovery. Unfortunately, in today's regulatory and business environment, it is impossible for employees to stay up on codes and complete tasks without help. Therefore, the modern approach to tax management has evolved to more heavily rely on technology. Organizations that want to improve their sales and use tax performance should heed the following recommendations:

- **Automate.** Automation ensures that standards are set, and followed, in order to minimize mistakes and hasten processes. As such, Best-in-Class organizations are 47% more likely than All Others to have automated workflows for tax preparation, filing, and remittance / recovery. This includes streamlined processes for calculating taxes across multiple geographies.
- **Track and measure.** In order to prepare for audits, as well as quantify their impact, organizations must understand the impact that noncompliance will have on the organization. The Best-in-Class are more likely than All Others to track the costs associated with negative audit results as well as assess the potential risk of receiving those results.
- **Integrate.** Creating a "one stop shop" for tax information is essential for automation. Half of all respondents have integrated business solutions that create a complete and auditable system of record. Further, the Best-in-Class are more likely to integrate ERP with additional tax point solutions, such as rate calculation, that can utilize the data contained within ERP to make tax management easier.

Through software-assisted automation, tax managers can make sense of a complex regulatory environment.

For more information on this or other research topics, please visit [www.aberdeen.com](http://www.aberdeen.com)

### Related Research

[The Integrated Accounting Environment: Accuracy and Efficiency at a Lower Cost;](#)  
September 2013

[Enhancing Sales and Use Tax Compliance: A Tax Manager's Guide to Reducing Audit Risks and Improving Productivity;](#)  
June 2012

[Cloud Tax Management for SMBs: Cost-Effective Measures to Ensure Indirect Tax Compliance;](#)  
March 2012

[Ensuring VAT Compliance in the Global Market Place: Reducing Audit Risks and Improving Supplier Relationship;](#)  
March 2012

**Author: Nick Castellina, Senior Research Analyst, Business Planning and Execution ([nick.castellina@aberdeen.com](mailto:nick.castellina@aberdeen.com))**

For more than two decades, Aberdeen's research has been helping corporations worldwide become Best-in-Class. Having benchmarked the performance of more than 644,000 companies, Aberdeen is uniquely positioned to provide organizations with the facts that matter — the facts that enable companies to get ahead and drive results. That's why our research is relied on by more than 2.5 million readers in over 40 countries, 90% of the Fortune 1,000, and 93% of the Technology 500.

As a Harte-Hanks Company, Aberdeen's research provides insight and analysis to the Harte-Hanks community of local, regional, national and international marketing executives. Combined, we help our customers leverage the power of insight to deliver innovative multichannel marketing programs that drive business-changing results. For additional information, visit Aberdeen <http://www.aberdeen.com> or call (617) 854-5200, or to learn more about Harte-Hanks, call (800) 456-9748 or go to <http://www.harte-hanks.com>.

This document is the result of primary research performed by Aberdeen Group. Aberdeen Group's methodologies provide for objective fact-based research and represent the best analysis available at the time of publication. Unless otherwise noted, the entire contents of this publication are copyrighted by Aberdeen Group, Inc. and may not be reproduced, distributed, archived, or transmitted in any form or by any means without prior written consent by Aberdeen Group, Inc. (2014a)