Sales & Use Tax Returns Outsourcing

Questions to Ask Before You Commit

Mark Sergas
Services Line Leader
Vertex Inc.

WHERE TAXATION MEETS INNOVATION

Overview

Each year, the number of companies turning to a third party to handle sales and use tax returns increases by nearly 15 percent.[1] Why? Because of growing tax rate complexity, the increasing frequency of audits, and the overwhelming burdens on tax staff. The bottom line is the risks and penalties associated with inaccurate sales tax compliance have become too great. As a result, companies turn to outside providers that they believe can manage the complexity and volume of data more effectively while reducing their risk.

However, not all outsourcing providers are the same. Choosing the wrong partner to handle returns could actually *increase* the likelihood of underpayments, overpayments, even material weaknesses. This occurs when companies hire an outsourcing provider that merely takes their data file and blindly generates returns.

The Challenge of Managing Sales and Use Tax

If you think your tax department has sales and use tax compliance under control, think again. A sea of change is underway. Over the past two years, state tax revenue has plummeted across the country, resulting in sizeable budget shortfalls. To make up the difference, states and localities are rapidly increasing tax rates and expanding their taxable base to cover more services and products. Their goal, of course, is to collect unrealized sales tax revenues to bolster budgets.

All of this activity has resulted in an explosion of tax rules and regulations. There are currently more than 99,000 tax laws with which your business may need to comply in the U.S. alone. This increasing complexity makes it extremely difficult for corporate tax teams to double-check tax calculations and process monthly returns to all the required jurisdictions – accurately and on time.

Choosing the Right Outsourcing Partner

So how should companies evaluate potential returns outsourcing providers? What should they look for? Following is a candid discussion of the risks companies may face in making that strategic decision – or companies looking to switch providers – and how to avoid them.

Not all outsourcing providers are the same. While a large percentage of sales and use tax processing *is* repetitive, a great deal can go wrong. You want a returns outsourcing provider who does more than just take your transaction data and generate returns. You need an outsourcer with deep expertise in not only sales and use tax, but also tax technology. In addition, you need a provider committed to personalized, end-to-end service that not only ensures your tax compliance is accurate, but also proactively helps your company stay in good standing with tax authorities. Your chosen provider should also put into writing all agreed-upon service levels and standards.

There are significant consequences to choosing the right or wrong service provider. In many cases, bigger is not always better. To help you evaluate and choose the right returns outsourcing provider for your business, be sure to ask the following questions.

1. What does your service include? Do you outsource any part of the process?

Not all returns outsourcing providers offer the same scope of service. Basic service providers just prepare returns, but they do not sign, file, and certify the returns or handle payments. Some companies will advertise that they handle the entire process, but in truth, they often outsource part of the process, such as payment handling, to a third party. Outsourcing the payment process means they lose visibility into – and control over – this critical step. What does this mean to you? Significantly increased risk. For example, what happens if the second outsourcing firm overlooks something, has a communication breakdown, or sends payments out late? In addition, should errors occur, who do you ultimately hold accountable?

Some outsourcers even offshore entire steps of the process, such as funds management or notice management. In the case of notice management, outsourcing saves them a few dollars on scanning, but it makes notice management a fragmented, multi-step process – and one that is more likely to be handled by inexperienced people. At the same time, it can cause delays and mishandling of this critical communications piece with tax authorities, resulting in needless additional scrutiny, penalties, interest, and audits.

Even if a service provider does handle returns processing, notices, and funds management in house, it is worth digging a little deeper to find out whether their process is truly integrated. The more internal handoffs there are between people and departments, the more risk they introduce into the process. The lowest risk,

[1] The Rising Tide: Regulation and stakeholder pressure on tax departments worldwide. KPMG International, 2007.

highest-benefit outsourcing process is one where the company handles the entire process *internally* so they closely manage every step – from data collection to funds remittance. Ideally, you want to have one seasoned, dedicated tax professional who handles (or directly oversees) every aspect of your returns and payment process, month after month. This person becomes intimately familiar with your business, the jurisdictions where you do business, and your sales and use tax trends. That way, your assigned tax professional can look at your account holistically and ensure nothing falls through the cracks.

2. Will you help us prepare for an audit?

Many tax outsourcers believe that their responsibility ends when they generate returns or submit payments. In many cases, they are simply not prepared to help with tax audits. The fact is, as state and local governments struggle to meet their financial obligations, companies have to expect to get audited today. So whoever handles your sales and use tax returns needs to be able to support you through the audit process by providing fast access to everything you need, including notice reports, archived tax data, returns, and even special reports to meet specific auditor requests.

Ask what kind of audit support you will receive and get the details in writing. For example, they should be able to easily gather and organize the information for each audit in a timely manner, saving you a great deal of time and effort. Look for a provider that will get to know your sales and use tax in depth, learn about your business, and understands and fully documents *exactly* how your compliance was prepared from start to finish. Equally important, look for an outsourcer with expertise on taxability and jurisdictional requirements so they can ensure you understand audit issues and how to substantiate your position.

3. What is the experience level of your staff? Will our company have a dedicated account executive?

Most tax outsourcing firms rely heavily on junior-level administrative staff with little or no experience in sales and use tax. Many even lack basic training in accounting. A typical outsourcing employee essentially learns about sales and use tax while working on your account. To make matters worse, many outsourcers have extremely high turnover rates. What does this mean to you? Your account team will eventually become knowledgeable about your business, but you are likely to lose them at any time.

Given the complexity and risk associated with sales and use tax compliance, look for a returns outsourcing provider with experienced professionals who can identify issues early, make strategic recommendations, head off problems, and help you make informed decisions. They should have the tax expertise to answer the following types of questions:

- Can you tell if we have established a taxable presence in a jurisdiction just by looking at our transactions?
- What are my obligations to collect tax for services versus products in the new jurisdiction we are now operating in?
- How often does this particular jurisdiction require filings? Do they require prepayments?
- Can you help me with voluntary disclosures and registrations if I need them?
- Can you help us identify and address areas of risk in our sales and use tax processes?

In addition to asking about overall staff experience, find out if your potential service provider will assign a dedicated account executive. You want a single point of contact and quality control, as well as a tax expert who is responsible for knowing your business and your tax issues intimately.

4. How accurate is your tax data and what is the quality of your returns technology?

Most corporations today use a manual or disjointed process for determining taxability and calculating sales and use tax, which increases the likelihood of errors. As a result, they can greatly benefit from an outside expert who can “sanity check” their sales and use tax calculations, identify trends and potential errors, and fix issues before returns are submitted. Viewed from this perspective, the quality of your outsourcer’s tax data as well as their returns management software can affect your bottom line.

Many outsourcing providers contract with other vendors for tax rates and therefore do not guarantee the accuracy of their tax data. Others use third-party tax data software, which is only as good as the vendor who provides it, the outsourcing provider’s understanding of how to use it, and their discipline in applying the proper rate updates in a timely fashion.

Look for a service provider with recognized expertise in sales and use tax *and* technology, particularly if your tax department and IT department have not clearly communicated their specific requirements to one another. Your outsourcing provider should be able to provide some level of assurance as to the accuracy of their tax data. Ideally, your service provider should also offer professional services to help you integrate systems and enable automatic data collection from host financial systems.

5. What security will you provide for our company's data, our funds, and our access to your systems?

Security must be a top priority when selecting a returns outsourcer, especially if you are entrusting your service provider with funds to pay your tax bills. You need to consider security in three different areas: funds management, data management, and client access.

Systems and integrity for funds management

Some outsourcers co-mingle funds from clients in a single bank account because it is not only easier for them to manage, but it also allows them to earn as much interest as possible on the float of their clients' funds. The problem can lie in poorly managed funds. Your funds could be accidentally used to pay another company's taxes – and not be available when *your* payments are due.

For this reason, choose an outsourcer that does not co-mingle funds. In addition, look for a provider that gives you multiple options on how you can pay, including ACH credit, debit, check, or wire. Make sure they notify you when funds are needed in advance, provide reports that support the amounts requested, and are not earning undue interest on your money by requiring it too far in advance of distribution.

Security for client data management

Many outsourcers also co-mingle your data with that of other clients in a single database. Co-mingling data can lead to errors in filings, so make sure your outsourcer has a secure, individual database for your company's proprietary information. In addition, verify that they have industry-certified security standards in place for all communications so your company's tax and financial information is kept confidential.

Security for client access

Consider how your outsourcer will be sending and receiving your tax information. Some service providers allow you to email your tax data spreadsheet or database, or upload it to an FTP site. Both can be risky given that these are such insecure technologies. Other companies give you access to a portal for uploading data and generating reports. Choose a service provider with SAS 70-audited technologies and a Cyber Trust-certified portal for all collaboration activities and data transfers, complete with confirmations at every step in the process. Your service provider's portal should include user access controls that you can define.

6. How much of our data will you store after returns filing? Can we access our data at any time?

In many ways, working with an outsourcing provider is a partnership. If the relationship should falter, you need a clear understanding of how quickly and easily you can access *all* your tax data so you can switch to another outsourcer or move processing back in-house. In addition, you want to be sure your service provider saves the transaction data used to generate returns. This data can prove valuable when questions arise from tax authorities.

Therefore, when evaluating service providers, find out what types of tax data they store and look for a partner that gives you real time, self-service access to your tax data – whenever and wherever you want it. You should be free to download anything and everything on demand and transition to a new service provider at your convenience. After all, it is *your* data.

7. How will you manage communication with tax authorities?

A good outsourcing provider can act as a knowledgeable intermediary with taxing authorities, helping you negotiate accountability for past oversights to minimize interest and payments. If your outsourcing company handles communications poorly, they can raise tensions with tax authorities and trigger unduly harsh treatment. When evaluating service providers, explore the degree to which they can effectively manage your account with tax authorities. For example, consider the following:

- Will you feel comfortable having their staff represent your business? Can you view the correspondence they sent to the jurisdiction?
- Can you trust them to quickly provide accurate information and reports to prove your organization's compliance?
- Can they proactively handle tax authority notices before they really become a problem? Can you view the progress real time?
- Do they certify their filings, payments, and mailings to ensure quick and easy proof can be provided to tax authorities of proper compliance before it escalates into an audit?
- Do they provide a service to check with tax authorities proactively on your behalf to make sure your account is in good standing with tax authorities?

8. How can we monitor your work so we remain in control?

One of the primary concerns tax departments have regarding returns outsourcing is fear of losing visibility and control – and for good reason. Too often, outsourcers fail to provide sufficient visibility into what is being done, when, and by whom. This forces you to waste time checking up on your vendor's activities. It also introduces unnecessary risk into the process.

Look for an outsourcing provider with a robust, Web-based portal that gives you access to comprehensive workflow management, a real time view into everything that is happening with each jurisdiction and return, and a complete audit trail. Communications should be comprehensive and collaborative. For example, their system should automatically send emails when tax data is due, when they receive it, when you have returns to review and approve, and more. In addition, your service provider should provide online access to a wide variety of reports, including:

- Management reports that make it easy to see if everything reconciles correctly by jurisdiction and by date, as well as ties back accurately to your company's general ledger accounts
- Returns posted for your review with management reports (these should be available prior to submission to avoid costly filing errors)
- Trend reports that make it easier for both you and your outsourcer to identify errors and outliers – and fix them – before returns are filed
- Reports that notify you if tax has been collected in a jurisdiction where you are currently not registered

Taking the Next Step

In summary, not all outsourcing providers are alike. Expertise, technology, workflow, security, transparency, and quality of client service are critical parts of the equation. Finding the right returns outsourcing partner is a complex decision and one that has critical repercussions. But if you do the homework to find out what each outsourcing provider really brings to the table, you will make an informed decision that will bring real value to your tax department.

About the Author

Mark Sergas, Services Line Leader at Vertex Inc., is in his 10th year at Vertex. He has worked directly with more than 300 tax departments to help them deliver more value to their organizations and with the unique challenges they face. Mark has been recognized by the ITSMA for excellence in New Services Development and has a record of fostering the strategies and organizational changes necessary to achieve new and expanded lines of service business. He holds a BS in Logistics and a Master of Information Science from Pennsylvania State University. Mark is a member of the Technology Professional Services Association (TPSA).

Vertex Inc.

1041 Old Cassatt Road
Berwyn, PA 19312
United States
Phone: 610.640.4200
Toll-free: 800.355.3500

vertexinc.com

05.10

WHERE TAXATION MEETS INNOVATION