Cloud-Based Tax Technology's Growing Value to Retail

How a Software-as-a-Service Solution Simplifies Tax Complexity

Chris Livingston,
Director of Operations

VERTEX®

Contents

Executive Summary

This white paper looks at how a Cloud-based Software-as-a-Service (SaaS) tax solution can help tax and information technology (IT) professionals within retail companies address challenges while helping to increase business agility. After examining these retail-specific challenges, the paper reports on cloud-based tax technology benefits and then examines how tax and IT functions can work together to conduct an informed evaluation of SaaS tax solutions providers.

"That's been one of my mantras—focus and simplicity. Simple can be harder than complex: You have to work hard to get your thinking clean to make it simple."
– Steve Jobs

Introduction

Given the mountains of complexity confronting retailers, it will take plenty of hard work—and some clear thinking on tax technology—to maintain focus and to achieve the focus and simplicity that Jobs describes.

Ongoing globalization, intensifying competition, an ever-increasing regulatory compliance burden and rapidly evolving consumer preferences represent multi-layered challenges that generate more costs and additional complexity. Of course, complexity has for a long time defined the retail industry's tax management challenges. More recent practices and behaviors—such as mobile purchases, click-to-brick returns, store returns that cross tax jurisdictions and more—ensure that this complexity will continue to intensify. Addressing this consequence presents tax technologists with a challenge, as well as an enticing opportunity, according leading retail experts.

"The retailers that will move ahead of the pack in the coming year are those that can deliver a consistent, clear, clean, simplified, and seamless message across all channels," asserted Alison Kenney Paul, former vice chairman and U.S. Retail and Distribution leader for Deloitte LLP, in her firm's 2015 *Retail Industry Outlook*.[1]

This remains the case for 2016 and beyond. Cloud-based tax technology, in particular, represents a crucial focal point—and an enticing opportunity—for tax, information technology (IT) and business leaders and professionals who are committed to boosting organizational agility, driving down costs, creating a culture of innovation and improving the overall quality of tax processing. Leveraging this opportunity requires an understanding of how cloud technology can help address a number of issues that retailers currently face.

A Tax Cloud Glossary

The following are three of the more common and important phrases that relate to the use of Cloud-based applications in tax processing, as well as throughout the rest of the enterprise:

- **Cloud Computing:** This umbrella term describes the technical environment that enables a company to access and use software and IT infrastructure that is located outside of the company's physical boundaries. In practical terms, "cloud computing" does not imply one of the business models described by the more specific phrases that follow.
- **Hosting**: This term refers to a model in which a company outsources IT infrastructure while maintaining ownership (through licensing) of the software.
- **Software-as-a-Service (SaaS):** This phrase describes a software-subscription business model through which the software is rented rather than owned. The software is hosted remotely and is accessed through an Internet connection, instead of through an interface that is part of an on-site software installation.

The Future of Retail: More Global, More Competitive and More Complex

Retailers are accustomed to challenge given the unique demands of their industry, including ever-changing consumer preferences, razor-thin operating margins and the impact of seasonal revenue cycles. To help offset these detriments to profit performance, retailers of all sizes must demonstrate the agility to quickly scale up to reap maximum benefit from infrequent, but recurring, retail-specific revenue opportunities such as Black Friday and Cyber Monday.

Retailers also contend with other disruptions and drivers of change, including:

- **Intensifying competition**
  Tax, accounting and consulting firm BDO's 2015 analysis of the largest publicly traded U.S. retailers' 10-K filings identifies intense competition and consolidation as "two mainstays of the post-recession retail landscape." These factors, the report indicates, are "prompting retailers to strategically vie for opportunities to expand their brands and provide their customers with speed, convenience and unique products."[2]

- **Increasing globalization**
  The strategic search for growth opportunity continues to drive more retailers into new global markets. Many emerging economies offer access to exploding populations of middle-class consumers. These promises are complicated, however, as recent policy responses to spikes in economic volatility demonstrate.

  A prime example of this type of policy reaction is Brazil, which introduced a series of tax increases earlier this year to increase government revenues.[3] Today, with its more than 85 different taxes, Brazil features one of the more complex and dynamic tax environments in the world.[4]

  These types of frequent legislative changes as well as court rulings on major tax disagreements complicate tax compliance throughout many global regions.

  Further complicating a retailer's foray into the global economy is the requirement that retail tax professionals understand and comply with specific e-commerce rules and requirements, including value-added taxes (VAT). Other factors that add to the complexity of going global include the need to manage foreign currencies, custom duties and cross-border shipping and returns activities.

- **Growing regulatory and tax complexity**
  In addition to the significant tax complexity attached to global expansion, retailers face major challenges in their efforts to comply with fast-changing state, local, national and, in some cases, global tax regulations.

  On the domestic front, retailers face the longstanding challenge of managing the taxability of multi-channel transactions; exposure to the frequent audits that high-volume transaction businesses are subjected to; coverage for unique compliance requirements associated with jurisdictional special tax rates and rules; and other ongoing and frequently changing compliance requirements.

  New global tax regulations, such as the Organization for Economic Cooperation and Development's (OECD's) Action Plan on Base Erosion and Profit Sharing (BEPS) represents one of the most sweeping global tax changes in recent history, and it will have major direct tax implications for multinational entities (MNEs).[5]

- **Emerging technology and changing consumer behaviors**
  The current scramble by many smaller U.S. retailers to upgrade payment terminals to accept new chip-embedded credit cards reflects just one of many ways that technology advancements are reshaping the industry. Most of these changes are complex and expensive: The Retail Industry Leaders Association puts the cost of payment systems upgrades related to the more secure credit cards at $8 billion.[6]

  The current IT environment in a typical retail company consists of multiple point-of-sale (POS) systems, e-commerce systems, enterprise resource planning (ERP) systems and more. Deloitte Digital research indicated that digital interactions (via smart phones and other devices) were expected to influence 64 cents of every dollar spent in retail stores by the end of 2015, or $2.2 trillion. Just three years ago, digital interactions influenced only 14 cents of each dollar spent in brick-and-mortar stores.[7]

  Tax data flows through many of these systems, and onto a growing number of mobile, handheld devices and related technology (e.g., radio frequency identification, 3D printing and biometrics). These systems and devices increasingly interact with each other, which can result in substantial benefits (e.g., more sales) along with significant tax risks.

  All of these dynamics give rise to specific challenges all retailers are familiar with, including:

  - Slimmer profit margins and growing cost-reduction pressure.
  - The ongoing need to scale up/down quickly in response to seasonal demand combined with a strategic mandate for greater business agility.
  - Business continuity management (BCM) and disaster recovery (DR) challenges related to more global, more complex supply chains.
  - More regulatory compliance risks.
  - A growing need to serve customers via an omni-channel approach.

The Cloud's Growing Appeal to Retailers

Survey research indicates that cloud technology is an agility enabler (see "**Business Agility and Other Cloud Benefits**" side bar). When polled about the benefits of cloud technology, IT professionals routinely point to efficiency gains, greater employee mobility, and heightened innovation capabilities.

Cloud tax technology also delivers cost-reduction benefits that result in an overall lower total cost of ownership, as well as business continuity management (BCM) and disaster recovery benefits. Additionally, retailers that have implemented cloud tax technology identify speedier implementation, cross-channel support (point-of-sale, e-commerce, mobile, etc.) and scalability as benefits.

Given these advantages, the rapid adoption of cloud systems and technology throughout the enterprise makes sense.

In 2015, nearly one-quarter of all IT budgets were allocated to cloud computing, and the majority of this cloud investment went to SaaS solutions, according to an International Data Group (IDG) survey. Many of the survey's other findings show that cloud computing and SaaS are becoming the norm within companies:

- In the past two years the number of companies making these cloud investments have increased by 21 percent.
- Sixty-one percent of companies are evaluating additional technology investments (e.g., network virtualization) designed to optimize their existing cloud-related technology investments.
- The average cloud investment for organizations with more than 1,000 employees was $3.3 million last year.[9]

Business Agility and Other Cloud Benefits

Efficiency, employee mobility and innovation are key enablers of business agility, as evidenced by the following benefits which figured at the top of the list when roughly 1,200 IT professionals were asked to identify how enterprise cloud computing technology helped their enterprises:

1. Increased efficiency (55 percent);
2. Improved employee mobility (49 percent);
3. Increased ability to innovate;
4. Freed current IT staff for other projects; and
5. Reduced IT operating costs.[8]

IT-Tax Context and Considerations

Given the number and type of strategic challenges retailers confront, it is important for tax and IT professionals to clarify what the company intends to gain from an investment in a cloud-based SaaS tax solution. Achieving this clarity requires understanding:

1. The tax-IT partnership and business value;
2. Cloud-related security concerns; and
3. Questions to put to vendors.

The final activity is routinely emphasized by leading cloud-technology experts: "Companies cannot afford to ignore the promise of cloud computing, but they should not rush pell-mell into it," proclaims a PwC Strategy& paper.[10]

The Tax-IT Partnership and Business Value

Although cloud-based tax technology can significantly reduce traditional IT maintenance costs and workloads, some collaboration between IT and tax functions is still required. The foundation of a healthy tax-IT partnership is mutual understanding. And a good start would be for tax professionals to understand that IT functions—like technology itself—are in the throes of rapid evolution.

A primary component of IT's evolution concerns its growing focus on business challenges and business value. Former Gartner CEO Manny Fernandez, who now sits on the boards of several publicly listed companies, has advised CIOs to "stop talking about technology and talk about business," and to "frame conversations not in terms of costs, but in terms of revenue and EPS [earnings per share]." CTOs and tax professionals should keep in mind that CIOs are looking for opportunities to deliver business value, and that tax is an area ripe for adding value to the company. Framing tax technology investments in business terms can help IT partners understand the true value of these investments.[11]

Tax professionals also should keep in mind that CIOs are looking to deliver business value quickly. Time-to-value (TtV), a measure of the time it takes for the value of an investment to be realized, represents an increasingly important concept within IT functions, especially those within the retail industry. To become more agile, more retailers want to generate a return on investment (ROI) as *quickly* as possible. Fast-changing marketplace conditions are driving the need for new business technology needs to be met more quickly. Rather than 18-month technology implementations, companies need to start reaping the returns on investments in new technology within four to six months. Cloud-based technology can greatly reduce TtV.[12]

Cloud-Related Security Concerns

Security concerns routinely rate as a top cloud technology issue in surveys of IT professionals. Given the rise of cybersecurity breaches and the increasingly strategic nature of cybersecurity risk, it is imperative for CIOs and IT functions to be concerned about security—and to vigilantly guard their organizations against cybersecurity lapses.

It is also important to think clearly about the true nature of cloud security as well as the nature of recent, and massive, IT security breakdowns.

David Linthicum, a cloud technology consultant and the author of 13 IT-related books, asserts that survey findings concerning IT's cloud-security concerns "don't actually tell you whether the cloud is secure, only that IT pros perceive that cloud providers lack security" in an article titled *IT's Cloud Security Concerns do not Correlate to Actual Failures*: "But in reality, cloud security is much different than what these surveys indicate. Indeed, the larger cloud service providers are doing a good job. Because cloud computing is still a fairly new technology, the providers use current approaches and… mechanisms [that] many enterprises don't use internally."

Where cloud technology providers could improve, Linthicum explains, relates to how they describe their security capabilities and practices to buyers. As Linthicum concludes, "The metric that matters is not IT pros' personal concern but actual security breaches. The large data breaches that have made the news… have been nowhere near the cloud. All these big breaches are in traditional enterprise IT environments. Logically, you should be more afraid of internal, aging systems leaking your data than of cloud service providers and their modern, centrally managed security technology."[13]

To be absolutely clear, data security qualifies as a truly strategic risk in most companies. As such, data security must be rigorously and continuously maintained, regardless of whether the data resides in an onsite legacy system, an employee's smart phone application or on a cloud technology provider's server. Security requires attention, period.

When it comes to cloud-based tax technology, security concerns should be addressed by IT and tax professionals asking the right questions of potential providers who clearly communicate the robust security measures they have in place.

Questions to Ask Vendors

The importance of selecting the right information system is emphasized within the BDO report on the top risk factors the largest publicly traded U.S. retailers face. The report indicates that retailers face "new pressures" to "correctly implement new systems… it's also important that retailers make the necessary investments to keep these new technologies secure to minimize their potential liability for credit card fraud and mitigate a host of external threats."[14]

A major part of this investment consists of spending the time necessary to grill potential tax technology vendors on a host of factors, including but not limited to security. Some of the most valuable questions to put to prospective vendors, include the following:

Question: What, if any, industry standards are incorporated into the solution?

Rationale: A viable vendor will be well-versed in a full range of the industry's unique challenges and issues. Look for vendors with active presences in the Association for Retail Technology Standards (ARTS) and those who maintain alliances with other retail-specific technology providers.

Question: How many industry implementations has the vendor performed?

Rationale: Industry experience is crucial. The level of performance quality and service quality differs greatly among vendors. Some vendors provide retail POS solutions to *dozens* of customers while other vendors service *hundreds* of customers. Similarly, some vendors have limited POS-tax integration experience while others have completed numerous implementations across market segments while supporting compliance within increasingly complex jurisdictional requirements.

Question: How does the vendor keep up-to-date of rapidly changing tax rules and industry conditions?

Rationale: Find out what mechanisms a prospective tax technology vendor has to ensure compliance with tax holidays, tiered taxes, threshold and compound taxes, origin and modified origin states, bracket taxes and other industry-specific tax rules.

Question: How does the solutions architecture provide up-time assurances?

Rationale: All information systems require regular maintenance and updates. As retailers have embraced e-commerce and expanded globally, however, they can ill-afford to take their tax systems offline and stop calculating taxes, even for a brief period. Look for vendors that have architected their system (e.g., invested in pools of servers) so that it remains up and running during routine updates and maintenance.

Question: How is information security maintained?

Rationale: Responses to this question should include detailed review of annual SSAE16 SOC1 Type II and SOC2 Type II audit reports, which are standard reports for service organizations (including many cloud technology providers) to demonstrate compliance with standards developed by the Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA). The SOC1 report covering the processes used to support security controls and the SOC2 focuses on the technology aspects of security. Consistent with the AICPA standards, cloud technology providers would be wise to employ third-party security compliance programs covering the of host environment (e.g., like the certification provided by Verizon CyberTrust), dynamic application security (e.g., provided by leading vendors such as WhiteHat Security) and online transaction security (e.g., GeoTrust's certificate program).

Question: To what extent does the solution support tax needs across all sales and transaction channels and types—and how will it integrate with point-of-sale, ecommerce and other back-office systems?

Rationale: E-commerce and mobile sales represent fast-growing sales channels that tax technology must be able to integrate with. Cloud tax technology solutions should conveniently integrate with enterprise resource planning (ERP) systems along with all other systems and applications that contain relevant transaction data. These solutions should also be able to easily seamlessly integrate with any and all systems to support business operations across multiple channels.

Question: How scalable is the solution?

Rationale: Ask vendors how the solution can support product line expansion, and about the technology's ability to handle large volumes of SKUs. What about global expansion? Product-line diversity? How about the tax technology's ability to flex to handle non-traditional products as well as new sales channels, catalogs or call centers?

Conclusion

When tax and IT functions partner to select the right cloud tax technology, they can help the tax function become more efficient, more flexible and more innovative; they can also help lower IT maintenance and support costs—all of which boosts the overall enterprise's business agility.

This selection process is crucial and involves a lot of hard work. When executed carefully and comprehensively, this complexity-reducing work provides a payoff, as Steve Jobs has noted of similar efforts to achieve focus and simplicity: "[I]t's worth it in the end because once you get there, you can move mountains."

Endnotes

[1] *2015 Retail Industry Outlook: Interview with Alison Kenney Paul*: http://www2.deloitte.com/us/en/pages/consumer-business/articles/2015-retail-outlook.html

[2] *2015 BDO Retail RiskFactor Report:* https://www.bdo.com/insights/industries/retail-consumer-products/2015-bdo-retail-riskfactor-report

[3] Lewis, Jeffrey. "Brazil Announces Tax Increases for 2015," The Wall Street Journal, January 19, 2015: http://www.wsj.com/articles/brazil-announces-tax-increases-for-2015-1421707755

[4] Levy, Ernesto and Maciel, Ana Paula. "A Closer Look at Business Opportunities and Tax Challenges in Latin America: Understanding Transactional Tax Complexity in Brazil, Argentina and Mexico," Vertex 2015.

[5] Brennan, Bill. "BEPS Country-by-Country Reporting: The Practical Impact for Corporate Tax Departments," The Tax Adviser, June 1, 2015: http://www.thetaxadviser.com/issues/2015/jun/brennan-june15.html

[6] Sidel, Robin, "Card Liability Set to Shift," The Wall Street Journal, Sept. 30, 2015: http://www.wsj.com/articles/card-liability-is-set-to-shift-1443567562

[7] "Deloitte Digital study: Digitally-influenced sales in retail brick-and-mortar stores to reach $2.2 trillion by year-end" press release, May 13, 2015: http://www2.deloitte.com/us/en/pages/about-deloitte/articles/press-releases/retail-digital-divide.html

[8] *IDG Enterprise Cloud Computing Study 2014*: http://www.idgenterprise.com/report/idg-enterprise-cloud-computing-study-2014

[9] "State of the Cloud Report," CDW, Feb. 11, 2013: http://www.cdwnewsroom.com/2013-state-of-the-cloud-report/

[10] Kohl, Chris, "As IT Evolves, So Should Tax," Vertex *Tax Matters*: https://www.vertexinc.com/blog/tax-matters/it-evolves-so-should-tax

[11] Eyes Wide Open: Mitigating Risk in Cloud Computing," PwC's Strategy&, 2010: http://www.strategyand.pwc.com/global/home/what-we-think/reports-white-papers/article-display/eyes-wide-open-mitigating-risk

[12] Kohl, Chris, "Cloud Technology Accelerates Time-to-Value," Vertex *Tax Matters*: https://www.vertexinc.com/blog/tax-matters/cloud-technology-accelerates-time-value

[13] Linthicum, David. "IT's Cloud Security Concerns do not correlate to Actual Failures," InfoWorld, April 17, 2015: http://www.infoworld.com/article/2907880/cloud-security/its-cloud-security-concerns-do-not-correlate-to-actual-failures.html

[14] *2015 BDO Retail RiskFactor Report*: https://www.bdo.com/insights/industries/retail-consumer-products/2015-bdo-retail-riskfactor-report

About Vertex

Founded in 1978, Vertex Inc. is the leading provider of corporate tax software and services to automate, integrate, streamline or outsource tax processes for companies of all sizes, from small to medium-sized businesses to global multinationals. Vertex provides solutions for all tax types with industry-specific solutions for retail, communications, hospitality and leasing industries.

Locations

North America
King of Prussia, PA

Latin America
Sao Paulo, BR

Europe
London, UK

Asia Pacific
Chennai, IN

VERTEX®
Where taxation meets innovation

vertexinc.com