

White paper

The critical connection between **PROCUREMENT AND TAX**

How procurement can drive tax compliance, and how tax can drive procurement value

Introduction: Tax touches everything

Summary

For more than a decade, procurement teams have made great strides in equipping their organizations — in a cost-effective and convenient manner — with the products and services needed to execute strategic purchasing objectives. Rapidly changing, increasingly complex tax compliance requirements threaten to diminish the value procurement transformations deliver to the organization if not addressed hand-in-hand. The risk of tax determination and calculation errors arising throughout the purchasing process makes it imperative for tax departments and procurement organizations to forge a stronger partnership through alignment based on mutual understanding, process improvements, and greater technological connectivity.

Leading corporate procurement organizations strive to operate in a highly efficient manner. Savvy accounts payable (AP) teams work to automate the invoice-to-pay cycle, from invoice receipt through payment and the filing of monthly tax returns involving those payments. However, the innate complexities of indirect tax calculations and related accounting requirements often interfere with these objectives. Fortunately, this challenge can be resolved through better collaboration, and stronger technology integration, between procurement and tax groups.

The need for an improved procurement-tax partnership has soared thanks to substantial changes in both domains. Some of these changes rate as sweeping. As they progress deeper into digital transformation endeavors, procurement teams are leveraging cutting-edge technology platforms to deliver Amazon-esque experiences to internal customers so that they can make crucial purchases with greater speed and ease. Tax departments are leveraging their own advanced technologies, including tax engines, to address compliance demands growing ever more complex and numerous, while simultaneously applying deeper tax analytics and intelligence to strategic planning efforts. The rising complexity and magnitude of tax compliance risks are attracting board-level attention. As a result, corporate directors, CFOs, and other senior leaders have more stringent expectations concerning the need for unassailable tax compliance.

“In recent years we’ve seen more attention dedicated to governance over tax compliance, both at the corporate level and within the finance function,” asserts Vertex Chief Tax Officer for Transaction Tax Michael Bernard. “The expectation is that if you’re going to procure goods and services, the taxes on those offerings absolutely must be correct. Senior leaders understand that achieving and sustaining that accuracy requires high levels of collaboration and integration between procurement and tax groups.”

These escalating expectations prevail across industries, geographies, and regulatory jurisdictions. “If you’re purchasing and contracting with suppliers in more than one country, your procurement department and your indirect tax group need to work together to identify and manage any country or jurisdiction that presents significant tax compliance challenges,” notes Vertex VAT Director Peter Boerhof. “When a company has procurement contracts in multiple European countries, it can easily run into unexpected VAT liabilities.” Similar risks exist across the staggering number of U.S. jurisdictions that impose varying sales and use tax rules and rates.



This makes it imperative for tax and procurement teams to align on all of the tax compliance issues that arise throughout the procure-to-pay process. To do so, both groups should understand their partner’s perspectives and challenges, identify common compliance risks, and initiate steps to mitigate those risks in a way that satisfies tax compliance requirements while supporting proficiency’s drive for greater efficiency. (That’s the emphasis of this paper; other white papers in this series zero in on global tax-procurement challenges, leading practices in tax-procurement alignment, and the enablers of successful tax and procurement technology implementations.)

Getting to know each other, again

Forging a healthier connection between tax and procurement begins with developing a basic understanding of each group’s challenges while noting where those challenges overlap.

Tax professionals should keep in mind that the tax decisions on procurement transactions can be difficult for non-tax experts to understand. Providing a high-level overview of those sales tax compliance challenges can be a helpful way to initiate deeper collaborations with procurement colleagues.

“It’s helpful to consider the tax-related differences between the sales and purchasing processes,” notes Vertex Consulting Practice Leader Tiffany O’Neill. “In the sales process, companies know everything about the goods and services they’re selling. They know exactly what they’re selling, and who they’re selling it to. And their sales, accounting, and tax technology systems track all of the SKUs, product groups, and customer data needed to make accurate tax determinations and calculations.”

Contrast that visibility with most purchasing processes. While it’s clear what product or services are being purchased, there tends to be less tax-related information readily available about those products and services. Consider the procurement of software. Accurate calculations of the tax on software purchases hinge on knowing whether the application is off-the-shelf or customized, whether the application is installed electronically or from a disk, and whether it is hosted or on-premise, among other factors. There is a long list of other sources of tax complexity — challenges that require deep troves of tax data (correlated to the latest tax rules and rates) to address — throughout numerous procurement categories. Legal services give rise to difficult tax decisions. For example, many types of machinery and equipment purchased in the manufacturing industry are tax-exempt; others are not.

While procurement systems are designed to make it convenient and cost-effective for corporate buyers to make purchases, those platforms rarely possess the functionality needed to automatically make accurate tax determinations. That said, tax leaders and their teams should recognize the value of procurement processes and platforms — and the ways that complimentary tax technology can strengthen that value while reducing tax compliance issues that can produce high levels of manual intervention, hinder purchasing efficiency, and increase audit risks.



“It’s important for tax people to understand that procurement’s objectives are to equip the organization with the goods and services they need as conveniently and cost-effectively as possible,” Bernard says. “They develop strategic partnerships, make complex sourcing decisions, track spending data, and leverage cutting-edge technology to make purchasing as frictionless as possible. Yet many procurement teams are not familiar with how taxes need to be calculated in light of constantly changing rules and rates. That challenge is not at the top of their list.”

Nor should it be, Bernard emphasizes, given that compliance is ultimately the tax department’s responsibility. To fulfill that responsibility while collaborating with their procurement partners, tax teams should understand how procurement is evolving. Some of its most notable recent changes include:

Outsourcing and insourcing: To gain efficiency and reduce costs, many companies moved all or parts of the procure-to-pay cycle, including accounts payable, to internal shared services centers and/or to external outsource providers. This shift surged in the early 2000s in the U.S. and more recently in Europe and other regions. In recent years, however, this trend has reversed as labor arbitrage benefits declined and as automation improvements enabled companies to extract more insights — and value — from sourcing, purchasing, and AP data. Companies also brought outsourced procurement and accounting processes back in house, in part, because it could be difficult to access from external payment processors the data needed to comply with tax audits.

Customer experience focus: Taking a page from leading retailers and business-to-consumer companies, more procurement groups are treating their colleagues as customers while implementing process improvements and new technologies designed to greatly enhance their purchasing experiences.

Efficiency is also a focal point: Delivering a top-notch customer experience to colleagues requires procurement to make the purchasing process as easy buying an item on Amazon, eBay, or any other online retail site or digital marketplace. Procurement is striving to operate as efficiently as possible while making their vendors’ experience as convenient as possible, too.

Technology transformation: Some legacy procurement systems are homegrown and/or highly tailored to address unique, industry-specific purchasing nuances. These stand-alone solutions frequently lack the functionality needed to perform complex tax calculations. Many procurement groups use the procurement functionality within enterprise resource planning (ERP) systems. Both approaches are being subjected to upgrades and improvements more frequently as procurement leaders strive to generate more value for the business. Many advanced technologies procurement groups are embracing extend well beyond traditional ERP systems, such as digital procurement, e-invoicing, supplier risk management, e-sourcing, data visualization tools, and robotic process automation (RPA), among others.



Misalignment, manual work, and other compliance risks

As tax groups familiarize themselves with procurement's evolution, they should recognize that procurement likely needs a briefing on tax's own transformation. Keeping procurement partners knowledgeable of the tax department's top challenges can also help minimize tax compliance risks.

Procurement teams should know that that sales tax rules in the U.S. and VAT rules in Europe and other regions have been undergoing frequent and substantial changes in recent years thanks to the U.S. Supreme Court's Wayfair decision, rapid technological changes driving adoption of real-time tax reporting requirements in many countries, and other factors. "Communications between tax groups and tax administrations have become much more data-intensive throughout Europe, Latin America, and the Asia-Pacific region," Boerhof explains. "That's being driven by an increase in real-time reporting requirements, which make it crucial for companies to get their tax determinations and calculations correct as soon as a transaction occurs."

The rise of data-intensive compliance requirements has driven more tax teams to implement advanced tax automation. Procurement partners should be aware of the capabilities and integration options that advanced forms of tax automation offer. This tax awareness can help procurement teams work with their tax colleagues to mitigate several common issues that create heightened tax compliance risks, including:

A lack of tax knowledge: Tax compliance determinations are often neglected until much later in the procure-to-pay lifecycle, usually at the invoicing and payments stage. This is a risk because AP teams do not possess the tax expertise and organizational knowledge needed to apply the correct tax codes. This gap can lead to tax-coding errors, which at the very least generate the need for manual follow-up work that hinders procurement's efficiency. "Accurate tax calculations require master data and transactional data, which is not created by the AP department," Boerhof notes. "Also, if incorrect or incomplete data is entered into a system during the contracting or purchasing phases, AP cannot be expected to accurately process an invoice. Many noncompliant transactions are caused by incorrect data."

Overpayments and underpayments: The misalignment of procurement and tax-compliance practices can produce recurring errors that result in a company underpaying and/or overpaying taxes. Overpayments of sales or VAT eventually must be recouped through time-consuming, manually intensive detective work. The underpayment of taxes generates heightened audit exposure and can trigger substantial fines while damaging valuable supplier relationships.



Technological gaps: Cutting-edge procurement platforms deliver major advantages in the form of cost savings, larger volumes of spending data, better sourcing decisions, as well as speedier and smoother purchasing experiences. However, those benefits can be limited, or even eliminated, when the tax calculations on purchases are not performed in an automated and accurate manner. Since procurement platforms typically do not have the depth of tax data management functionality required to navigate a complex tax-compliance environment, those tools should be integrated with advanced tax automation solutions.

5 ways to strengthen the procurement-tax partnership

Identifying and mitigating those risks require collaboration. Procurement and tax teams can improve their working relationship, and clarify the tax implications of purchasing activities, via several practical approaches, including the following steps:

1. **Engage early:** The sooner tax and procurement teams discuss the tax implications of purchasing activities the better. It is also important for these groups to address these implications early in the procure-to-pay lifecycle as opposed to playing catch-up after the AP group processes an invoice. “Procurement should understand what data from the purchasing process needs to be used for tax decisions,” O’Neill notes. “The tax team needs to understand exactly how the organization uses the purchasing application. If the two groups can understand each other’s side of the equation early in the process, they can design business processes and select technologies that support procurement’s objectives while successfully automating tax calculations.”
2. **Connect the tech:** As O’Neill indicates, advanced tax automation can be integrated with procurement platforms. This technology connection requires an understanding of the data that each application needs to produce its outputs. “When tax is considered from the beginning of a new procurement system’s implementation,” O’Neill continues, “it goes a long way to ensuring that the tax engine will get the data it needs to do its work.” Much of this data — including the amount of the transaction, the type or category of purchase, the ship-to address, and other accounting details — resides on the purchase order. Invoices rarely contain sufficient data from a tax perspective, and tax needs complete data to determine whether exemptions apply and which rules and rates apply. “It’s exciting that these advanced procurement platforms and tax applications are available,” O’Neill adds. “By working together on these integrations, companies can greatly improve their end-to-end business processes throughout the finance and accounting function.”

About Vertex

Vertex Inc., is a leading global provider of indirect tax software and solutions. The company's mission is to deliver the most trusted tax technology enabling global businesses to transact, comply and grow with confidence. Vertex provides cloud-based and on-premise solutions that can be tailored to specific industries for every major line of indirect tax, including sales and consumer use, value added and payroll. Headquartered in North America, and with offices in South America and Europe, Vertex employs over 1,100 professionals and serves companies across the globe.

3. **Enlist your tech vendors:** Longstanding tax, accounting and procurement software providers have been working on integrations among their offerings for years. Leading vendors have developed convenient, efficient connections between their tools. Leveraging those integrations as efficiently as possible requires tax and procurement teams to clearly describe the functionality they need to their vendors and to work together on the integration.
4. **Consider KPIs:** Procurement vendors closely monitor key performance indicators (KPIs) related to spending volumes, costs, and purchasing patterns to continually root out inefficiencies and reduce overall procurement costs. Introducing tax-related KPIs to procurement teams can help organizations pinpoint where the greatest tax compliance risks exist. This is especially helpful within large organizations and/or companies with relatively high purchasing volumes. Tax KPIs may track the portion of accurate invoices processed, the frequency of tax code errors, and the number of manual interventions that need to be performed.
5. **Start smart:** Bernard notes that tax-related accuracy metrics will give organizations a good idea of where to target their improvement efforts. "When considering where to start, it's wise to think about the tax liabilities due to tax-processing errors that have arisen in the past," he explains. "It's also worthwhile to consider focusing improvement endeavors on the goods and services that are purchased at the highest volume and/or those purchases with the highest dollar amounts."

Conclusion: Tax supports procurement's objectives

Getting a handle on the tax compliance requirements throughout purchasing activities may initially seem overwhelming to procurement teams. "If you look at the individual components of the purchasing process, you will see more clearly where improvements related to tax compliance can be made," Bernard notes. "As you start piecing those discreet changes and improvements together, you'll see that you can automate the tax calculations on most of the transactions. That will fulfill the board's mandate to get tax right while helping procurement groups perform their work even more efficiently."

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