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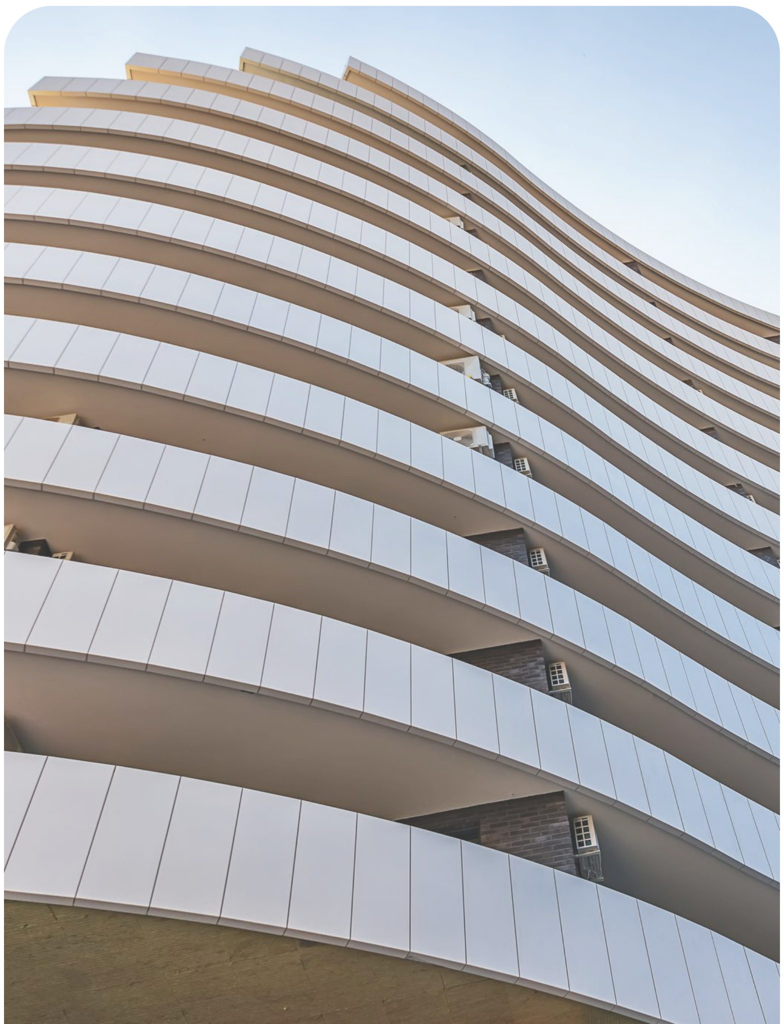
Manage Indirect Tax Like a Pro

A Five-Step Process That Every Tax Decision Maker Needs to Know

Executive Summary



When your company is growing and expanding, everyone's focused on innovating new products and services, selling them, and expanding into new counties, cities, states, and countries – as they should be. But in the rush to expand, fully understanding what's required to manage indirect tax can easily be overlooked. The fact is, indirect tax can quickly snowball in both complexity and workload beyond the capacity of existing compliance systems and processes.

Everything you do to grow your business can have hidden and significant indirect tax ramifications. But not every tax decision maker – which may be a tax professional, but can also be a company founder, controller, or C-level executive – will have the deep tax expertise to anticipate these ramifications and perform the due diligence to assess what they mean for your business. The result is significant compliance risks that can derail growth plans and deeply cut into profits.

In this e-book, we explore the indirect tax lifecycle in more depth and the potential areas of risk and exposure that you may not have considered.

The Five-Step Process Every Tax Decision Maker Needs to Follow

Managing indirect taxes – which encompass sales and use tax, consumption tax, property tax, and gross receipts tax in the U.S., value added tax (VAT), goods and services tax (GST), and even global tariffs – involves much more than a simple calculate-and-file exercise. It requires a disciplined, five-step process that includes:

Discovery

The first step is identifying every location where you need to register your business, including county, district, and town or city levels.

Have you overlooked areas where you should be filing, including areas where sales tax may not even be collected but other indirect taxes such as gross receipts tax is due?

Registration

Once you know where you need to register, you need to complete this process.

Do you know every step required to register your business with each relevant taxing jurisdiction?

Taxability Mapping

As a tax professional, you need to ensure the correct tax is on every invoice.

Have you done the granular research – or used a trusted, research-based tool – to determine exactly how to tax every product, service, and bundle your company sells or purchases?

Filing and Remittance

This step, also referred to as reporting, can be done manually (by mailing forms and a check) or electronically (using a tool or website). What's key is that you are 100% confident you are filing accurate returns and paying the appropriate amount due.

Are you trusting the system or manual process without validation?

Audit and Risk Assessment

Make sure all previous steps are set up properly because if there is a flaw, or if something was overlooked or mapped incorrectly, it will result in tax errors or failures to pay that may be picked up by an audit.

Are you confident that your discovery, registration, tax mapping, and filing and remittance activities are comprehensive and accurate for all indirect taxes – including use tax?

As your business grows and expands, the scope of these tasks and the risks involved will increase as well – sometimes in huge leaps that you may not be prepared for.

EXPERT INSIGHTS AND ADVICE FOR EVERY STEP IN THE INDIRECT TAX PROCESS

As the tax decision maker within your business, the buck stops with you.

Are you confident that you are 100% compliant and audit ready across all areas of indirect tax?

The following insights will help you to plan for and handle the increased scale and complexity of indirect taxes with accuracy and confidence.

Discovery

Are you fully aware of every jurisdiction – even at the county, city, and district level – where you have an obligation to report sales?

As you grow, you will likely sell more products and services in more geographic areas. Your discovery process – understanding where you have indirect tax obligations – needs to adapt based on what's changing within your business. Start by asking, "What's new, and how do I need to tax it?" "New" can be:

WHAT you sell – Consider new products and services as the rules for indirect tax vary widely by category and subcategory. This presumes that everyone in your business is aligned on what you sell and consistent in how it's represented when marketed and sold.

WHERE you sell – Know where your customers are because every location will have different ways of taxing items in those categories and subcategories. In addition, tax can change if you need to physically ship an item (i.e., customers buy from your website) or if they can download the item (such as a gift certificate, song, or design they can print locally.)

HOW you sell – Whether you're selling something over the phone, online, in person at a conference, or on the customer site, as well as other scenarios, can influence taxation at different jurisdiction levels.

WHO is buying what you sell – Know your customers because some customers have tax exemptions, for instance.

The due diligence you perform to answer these questions will uncover where you need to register your business. Too often, tax decision makers think they are covered, but they have actually failed to dig deeply enough to uncover all tax obligations. For example, you may be required to report sales you have made – including taxable, non-taxable, and exempt transactions – wherever you do business. So even in places where you end up not having taxable transactions, you still have a reporting requirement.

EXPERT QUESTIONS

Discovery

As the tax decision maker, leave no stone unturned during the discovery process.
Ask yourself...

Am I 100% certain my business is registered everywhere we are required to report sales?

Are there local registrations and tax obligations in those jurisdictions I need to be aware of, for example, at the county, city, or district level?

On the compliance side, are we accurately reporting and paying taxes in all jurisdictions where we are required to file?

Are there other types of indirect taxes that also need to be considered from a discovery perspective, beyond sales and use tax?

By the same token, only register where you need to because once registered, you must report even if you have no sales.

Registration

Have you correctly registered in every tax jurisdiction where you have a tax obligation – even at the state, county, city, and district levels?

When you know where you have new tax obligations, you know where you need to register your business. But every step of growth comes with new risks on the registration side of things. Different jurisdictions can have different registration processes and requirements. For instance, in some jurisdictions, whenever you have an employee physically in the geographic area – sitting at an event booth to sell, visiting clients, providing on-site services, and so on – you are required to apply for a permanent or temporary business license.

The process of discovery and registration can be overwhelming because your business is always crossing new geographic and tax category boundaries. So, you need to continuously ask yourself:

1. **Where are all the places where we have an exposure?**
2. **What does registration mean in each area of exposure involve?**
3. **What steps are required to register our business with each taxing jurisdiction?**
4. **Do we a financial solution, such as an ERP system, to automate invoice generation that records all sales transactions to our general ledger?**
5. **Do wehave a tax software solution that works with our ERP to ensure accurate taxation on the invoices you generated?**

EXPERT ADVICE

Registration

If staying on top of where you need to register and completing registrations demands more time, effort, and worry than you have to give, you're not alone. That's why many companies rely on a tax solution provider with consultants who can assist with this process.

The right tax solution provider can help you understand where you do business, what your registration requirements are, and how tax software can simplify things and reduce risk by helping to enforce registration compliance. They can also help you evaluate what software best fits your needs.

Taxability Mapping

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Are you 100% certain you have properly classified the taxability of every product and service you offer?

Taxability mapping is solely the responsibility of the tax decision maker – the person ultimately accountable for the sales tax that is printed on every invoice, remitted to the various levels of governments, and audited for accuracy. And it can seem very straightforward – until it's not.

The technicalities of taxability are vast, evolving, and unique to each industry and business. But the process generally involves a taxability tree for each product and service category, as shown in Figure 1.

For example, if a candy business makes a chocolate (level 1) that is a chocolate-covered bar (level 2) with a wafer inside, the product may be taxed differently in jurisdictions where it's classified as a candy bar (level 3) versus a bakery item (level 3).

This is not easy stuff, especially as your business expands its product and service offerings and geographic reach. Things get increasingly vague as companies move into digital products and services. For example, what if a product, which used to be shipped across borders, can now be 3D printed on site? Where is the tax due? Similarly, what are the tax issues if a business offers virtual services, embraces a subscription model, or opens a marketplace?

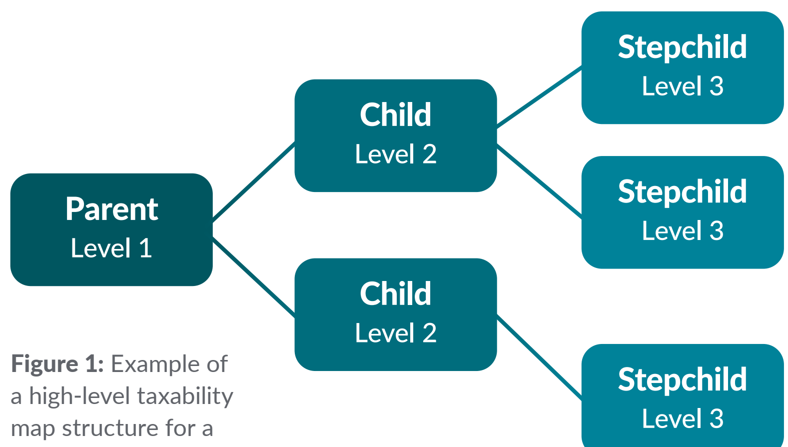


Figure 1: Example of a high-level taxability map structure for a product category

EXPERT ADVICE

Taxability Mapping

The easiest way to map taxability is to use a mapping tool built into a tax software solution with comprehensive taxability trees for all types of products and services. You determine what category each product or service you offer falls into, and the software's tax engine will apply the most up-to-date tax data to that category when a product or service is purchased. Once you assign taxability for an offering, you never need to update it unless something changes in how you make, define, market, or sell it.

Clearly, taxation can be a gray area – especially when determining if you need to pay use tax, as you won't know as much about taxability of products and services you don't sell. This is why large enterprises have large tax teams or hire one of the Big Four tax consulting firms to do research and advise them. But growth-oriented businesses typically don't have the budget for extensive, third-party resources. As the tax decision maker, consider working with a tax solution provider that offers affordable, expert tax-consulting services.

Filing and Remittance (Reporting)

Are you filing and reporting sales transactions in all jurisdictions where you are registered, even when you have no transactions for a period?

Filing and reporting activities involve more than just reporting and remitting sales tax. You also need to report all sales transactions (taxable, nontaxable, and exempt), as well as address wherever you have gross-receipt tax obligations. Tax jurisdictions expect you to track and report on all transactions on your tax return so they can validate all business transactions. In some cases, you may be asked to prove that a transaction you reported as either nontaxable or exempt was justified.

Once you've determined how tax should appear on your invoices, you need a system that takes invoice data from your ERP to a tax return for remittance in all the jurisdictions where you do business. As noted previously, once you've registered in a taxing jurisdiction, in most cases, you are required to file monthly, quarterly, or semiannually (at the jurisdiction's discretion) – even if you have zero transactions during that period.

Filing and remittance for indirect taxes can be done manually by totaling up all purchases and sales invoices, adding up the taxes paid for each, and sending the correct amount to the respective jurisdictions. Or they can be filed and remitted electronically, with your tax calculation software doing this work for you. You take the reports from your software engine, match it to your general ledger and tax records, and file the auto-generated return with the taxing jurisdictions.

EXPERT ADVICE

Filing and Remittance (Reporting)

As a tax decision maker, you can streamline and optimize the reporting process by:

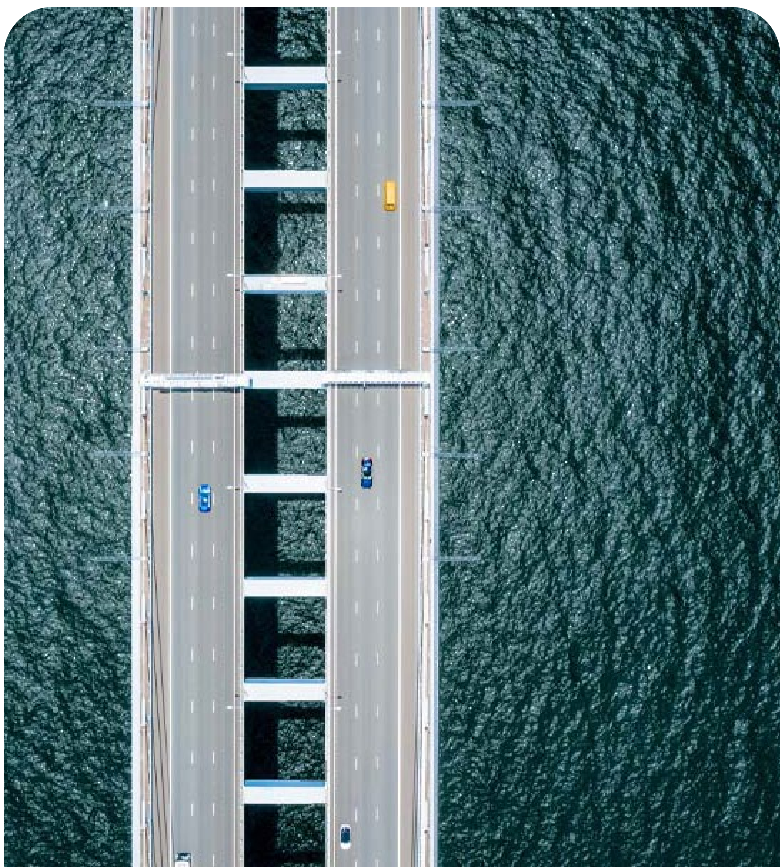
Making sure that you do your homework and research to ensure you are required to be registered in a taxing jurisdiction.

Ensuring that you are assessing the correct sales tax on invoices to customers.

Reviewing sales tax on purchases to ensure accuracy, because these transactions are also being reported to your taxing jurisdictions. Many businesses do not do a validation on purchases from their vendors to ensure invoices include the accurate taxes. This is a mistake, as any tax differences that indicate incorrect taxation on the original invoice would require you to self-assess the correct use tax on these transactions.

Audit and Risk Assessment

Do you have complete, audit-ready documentation to share with taxing jurisdictions seeking to validate your indirect tax compliance?



This is where the rubber hits the road. During an audit, you learn just how well you've carried out the first four steps to meet sales and use tax obligations, as well as other indirect taxes such as personal property tax and gross receipts tax.

Reporting capabilities are essential to navigating audits with speed and ease. You want the ability to instantly generate reports on anything and everything within your underlying tax data so that when an auditor (or even you, as part of an internal audit) wants to dig deeper, it's fast and easy to do. For example, if an auditor wants to look at what you've done during a certain time period for a state, county, or city jurisdiction, you can instantly sort data and provide the invoices for that time period. If they want to assess use tax by looking at everything you've allocated to office supplies for a particular period, you can provide it in minutes.

This kind of reporting and transparency not only simplifies audits, but also reduces worry about audit risk, as you can see and track everything you've done along the tax journey.

EXPERT ADVICE

Audit and Risk Assessment

Because there are gray areas when it comes to taxability (especially with professional services you've provided to customers or paid for through external workers), you should always do a risk assessment of your sales and use tax, at a minimum, and create a financial reserve to cover unpaid taxes on gray areas.

For instance, perhaps that IT services provider should have charged you tax on certain services provided on site but didn't, and it was a gray area for you. Your reserve will pay for these taxes as they are uncovered – and protect your bottom line.

Larry Mellon

Tax Director

Larry Melon is Tax Director in the Chief Tax Office at Vertex Inc., where he is responsible for providing insights, thought leadership, and customer-centric direction. He joined Vertex in 2005 as a sales and income tax supervisor and has served as tax manager since 2012. Prior to joining Vertex, he was a senior tax accountant and property tax manager at Foamex International. Mellon also held multiple roles at the Franklin Mint and is a member of the Institute for Professionals in Taxation (IPT) and Tax Executive Institute (TEI).

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 solutions that can be tailored to specific industries for major lines 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 1,300 professionals and serves companies across the globe.

To learn more, visit vertexinc.com.

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