



Strategies for SMB Indirect Tax Success

How tax leaders can optimize tax transformation while earning a seat at the leadership table

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a BDO State & Local Tax professional

Are you a tactician or a strategist?

This is an increasingly important question for indirect tax leaders in small to medium-sized businesses (SMBs) as they strive to design and execute strategies for success. New BDO research finds that “tax leaders who play a larger role in setting overall business strategy are driving positive business performance.” These leaders move “beyond the role of ‘Tax Tactician’ to take a seat at the business leadership table where strategic planning decisions are made.”¹

SMBs must address unique sales tax compliance challenges, including lean teams and budgeting constraints. “At the same time, smaller to mid-sized organizations also need to meet the same indirect tax compliance requirements that larger companies are subject to,” notes Larry Mellon, Tax Director in Vertex’s Chief Tax Office. “And although audit activity decreased during the pandemic, it is back to normal, and then some, today.” Happily, SMBs also have some unique advantages from a tax management perspective. “SMBs tend to have smaller back-office functions, and that lends itself to better integration from collaboration and technology standpoints,” notes a BDO SALT professional. “Larger companies can have difficulty bringing people out of their own worlds and getting them integrated.”

The trick for SMB tax leaders is to address these challenges while leveraging the opportunities. The best way to do so is by developing a sound indirect tax strategy, anchored by the twin lynchpins of advanced tax technology and a seat at the leadership table. This is especially helpful when finance-led digital transformation initiatives are on the menu.

To be sure, many indirect tax leaders operate as both tacticians *and* strategists; tactical compliance skills remain as important as ever. Making meaningful, “tax-beneficial” contributions to finance-led digital transformations and ERP migrations requires tax leaders to lean more heavily on their strategic competencies. This work entails collaborating with internal departments, putting together a persuasive business case for tax engines and other advanced tax technology, addressing the tax implications of transformation with business leaders, and participating in the transformation/ERP-implementation effort from day one.

A strategic indirect tax mindset also addresses challenges driving the need for tax transformation while working through all phases of the indirect tax lifecycle.

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Larry Mellon
Tax Director
Vertex Chief Tax Office

Trendspotting: E-commerce Adoption, A Talent Crunch and M&A Risks

The post-pandemic indirect tax landscape is dynamic, to say the least.

The swift adoption of e-commerce and omni-channel capabilities that early pandemic shutdowns accelerated continues today, albeit at a slightly less frenetic pace. U.S. retail e-commerce sales in the first quarter of 2023 increased 7.8% compared to e-commerce sales in the first quarter of 2022, according to the Census Bureau of the Department of Commerce. E-commerce sales in the first quarter of 2023 accounted for 15.1% of total U.S. retail sales.² This e-commerce growth has occurred as most U.S. states adopted and updated their post-Wayfair tax rules – including marketplace facilitator laws, which all states with general sales tax requirements now have on the books.

“We’re seeing Wayfair and marketplace facilitator requirements continue to have major impacts on tax compliance in the SMB market,” reports BDO. “More companies are using an automated tax solution to manage Wayfair rules, and we think that trend is even more pronounced among SMBs.”

Those tax technology investments, which are increasingly cloud-based, also help indirect tax leaders address a vexing tax talent management challenge. The shortage of accounting talent, which is a primary source of tax talent, is worsening, according to data from the U.S. Bureau of Labor Statistics: at least 300,000 U.S. accountants and auditors have left their jobs in recent years, which amounts to a 17% decline in overall industry employment. Plus, fewer students are graduating with accounting degrees than in previous years, according to the American Institute of Certified Public Accountants (AICPA).³

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BDO highlights another challenge bearing down on many SMB tax groups: merger & acquisition (M&A) activity and the due diligence efforts that accompany it. “We encounter a substantial amount of M&A activity while working with SMBs,” they note. “Every buyer wants to identify risk exposures, including those related to sales and use tax processes. If a tax risk is large enough, it can slow the deal or even lower the sale price.”

“This review process begins with discovery and continues through the technology implementation,” Mellon notes. “The insights and knowledge generated through this process will ultimately help optimize those technology investments.”

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From Discovery to Implementation: The Indirect Tax Lifecycle

Those and other challenges make it imperative for tax groups to address, and improve, each phase of the indirect tax lifecycle. While these evaluations are productive at any time, they are particularly valuable prior to an ERP system implementation or cloud migration and/or a tax technology upgrade. “This review process begins with discovery and continues through the technology implementation,” Mellon notes. “The insights and knowledge generated through this process will ultimately help optimize those technology investments.”

The six phases of the indirect tax lifecycle include:

1. **Nexus determination:** This evaluation identifies all of the nexus thresholds and tax compliance requirements a company is subject to.
2. **Taxability evaluation:** This evaluation identifies all of the products and services that are taxable in various jurisdictions.
3. **Exposure quantification:** This risk-based assessment identifies all potential compliance and auditing exposures.
4. **Mitigation and disclosure:** The objective of this phase is to create an action plan for mitigating compliance exposures and, when needed, reporting those exposures.
5. **Sales tax system selection and implementation:** This work consists of identifying tax technology improvements that will help improve compliance efficacy and efficiency while limiting audit risks.
6. **Sales and use tax compliance:** The ultimate goal of working through this lifecycle is to establish – and sustain – sales and use tax compliance.

BDO stresses that most of these phases are interrelated. “These steps overlap and often should be conducted in tandem,” they explain. “For example, when a company is considering implementing new tax automation, we definitely want to understand what its nexus footprint looks like. That helps drive the configuration and setup of the tax system.”

Exemption Certificates and Other ‘Gotchas’

Working through the indirect tax lifecycle is both an optimization exercise and an opportunity to strengthen risk management. Non-compliance, and the audit exposure it creates, amount to the largest risk that indirect tax groups must mitigate and manage. Unfavorable audit findings can trigger fines and other penalties. In worst-case scenarios, negative audit findings can have negative impacts on the customer experience and even shareholder value.

“When compliance errors are discovered – either via an internal review or an audit – it often creates a difficult customer-relationship dynamic,” Mellon explains. “You may have to contact a customer and say, ‘We didn’t calculate the tax correctly, and we need to collect it from you now.’ How will that affect the customer experience?” This issue can rise to the level of a strategic risk if the customer comprises a large enough portion of a company’s revenue.

Tax leaders can mitigate compliance risks, audit exposure and customer experience risks by avoiding the following “gotchas” that contribute to non-compliance:

- **Entering new tax jurisdictions:** Tax groups generally are well-versed in the tax compliance ramifications of the products and services their companies sell. Keeping pace with new tax jurisdictions – and their fluctuating mass of tax rules and rates – that companies enter when selling offerings to new customers in new geographies is more challenging.
- **Exemption certificate management:** Managing sales tax exemption certificates represents a substantial and widespread SMB challenge, one that frequently attracts attention from auditors. “Tax jurisdictions certainly want to look at those exemption certificates, and often want to scrutinize invoices to perform deep dives on all the exemptions that have been issued to ensure their validity and applicability,” Mellon reports. BDO agrees: “We see exemption certificates as a big gotcha.”
- **Business growth:** Nearly every major business decision, from postponing a large capital project for five years to selling widgets in new markets, has tax implications. “When indirect tax teams fail to monitor business changes and the tax registration and determination implications of those changes, compliance problems can arise,” Mellon says.

Indirect tax teams can also take a proactive approach to optimizing finance and tax transformation initiatives.



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Four Ways to Improve ERP and Tax Technology Implementations

The following actions and insights can help indirect tax leaders provide valuable, early input to larger finance-led digital transformations and ERP cloud migrations earlier while making a stronger case for tax technology upgrades to be included in these initiatives:

- 1. Understand your tax compliance requirements:** Does your company do business in a single tax jurisdiction (unlikely) or in multiple jurisdictions (far more common)? What geographies and corresponding tax jurisdictions might the company enter within the next few years? What city, local and district sales tax rates and rules apply to bricks-and-mortar and online transactions? Where are products and services shipped to, and/or consumed?
- 2. Connect compliance requirements to ERP and tax technology requirements:** Answering those questions in a comprehensive and accurate fashion will ensure that this discovery process yields practical and valuable insights concerning the tax-related functionalities and capabilities that should be included in the transformation effort. By mapping indirect tax compliance requirements to ERP and tax automation functionality, the implementation team will configure new systems in a tax-optimal fashion while mitigating compliance and audit risks.
- 3. Ensure data access, accuracy, and breadth:** Accurate tax determination and calculation hinges on access to accurate data. Developing and sustaining a robust audit defense capability also depends on data access, BDO points out. Indirect tax teams should ensure that a new ERP system and integrated tax engine can access the data – on customer invoices, from all tax jurisdictions, and from accounts receivable among other sources – required from tax determination, calculation, remittance and audit-defense perspectives.
- 4. Work closely with internal departments:** Since tax-relevant data resides in different parts of the organizations, indirect tax teams should collaborate with those “data owners” to ensure that this information is accessible. BDO notes that this collaboration delivers other benefits as well. “Companies constantly grow and change,” they said. “When indirect tax works closely with other internal departments, they tend to learn about growth plans ahead of time, and that helps keep tax aligned with business growth.”

Dotting Your i's: Overcoming Implementation Challenges

Indirect tax leaders also should recognize and address two pervasive implementation challenges that crop up during finance-led digital transformation and ERP implementations.

These obstacles boil down to involvement and influence:

- **Involvement:** This challenge relates to *when* the tax group's participation in the implementation effort begins. Ideally, that involvement should start during the initial planning phase of the initiative. In practice, tax-related technology considerations are often addressed too late – well after the implementation project begins. “We often hear from tax groups that the project team came to them after the ERP solution was purchased and the implementation effort had begun,” Mellon reports. In those cases, tax groups have to scramble to learn new processes that affect their tax compliance activities. Worse, some tax groups discover that the new finance system doesn't work well with their existing tax technology solution. “Indirect tax leaders should make sure they have a seat at the table so that finance and IT leaders understand the tax implications of a new ERP investment,” Mellon asserts. “Those discussions should take place before any contract is signed.”
- **Influence:** Finance-led digital transformation presents indirect tax groups with a valuable opportunity to upgrade tax automation. Leveraging this opportunity hinges on putting forth a compelling business case for new tax automation. BDO suggests starting with a thorough cost-benefits analysis. While costs – such as software licensing fees and consulting that support implementation – are fairly easy to identify, many tax teams don't realize the benefits the new tax technology will deliver. BDO runs through several categories of benefits, including reductions in error rates, better tax-planning decisions, audit-defense improvements, lower external labor costs (e.g., co-sourcing and consulting services), and a significant increase in the tax group's value-added contributions that materialize when tax professionals spend less time on manual tasks.



Concluding with a Look Ahead

The need for indirect tax groups to advocate for a seat at the decision-making table will only intensify in the coming years, given the compliance challenges looming on the horizon.

BDO points to the adoption of e-invoicing requirements by a growing number of global tax jurisdictions outside the U.S. “E-invoicing regulations require taxpayers to comply much more quickly,” they note. “While these types of requirements haven’t hit the U.S. yet, they will eventually arrive here.”

Various forms of digital taxes also promise to place new pressures on indirect tax compliance. U.S. sales and use taxes have applied to digital books, music and videos for years. While there have been laudable moves to standardize the meaning of “digital goods” (e.g., the standard definition put forth by the Streamlined Sales Tax Governing Board), digital advertising tax legislation and rules vary, and continue to trigger legal battles (e.g., Maryland’s digital advertising services tax). Plus, more states are considering new ways to tax cloud computing services, non-fungible tokens (NFTs) and cryptocurrencies.⁴

“It’s safe to say that we’re going to see digital taxes continue to evolve,” Mellon adds. “Tax jurisdictions want their revenue, so it’s important to track these developments.”

That monitoring activity represents another component of the tax strategist’s skill set, as the BDO research underscores: “As the C-suite works to comply with evolving regulations, meet stakeholder expectations, and navigate economic uncertainty, the tax practitioner’s strategic input is key to enhancing resilience and achieving business success. Consequently, tax leaders are broadening their purview from the core priority — managing tax liability — to leveraging strategic tax approaches for effective business outcomes.”⁵

End Notes

¹2023 BDO Tax Strategist Survey, <https://insights.bdo.com/2023-Tax-Strategist-Survey.html>.

²https://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf.

³Who’s Balancing the Books? Korn Ferry Insights:
<https://www.kornferry.com/insights/this-week-in-leadership/who-is-balancing-the-books>.

⁴2023 Sales Tax Trends: Digital Taxes Take Off, George L. Salis, Vertex:
<https://www.vertexinc.com/resources/resource-library/2023-sales-tax-trends-digital-taxes-take>.

⁵2023 BDO Tax Strategist Survey, <https://insights.bdo.com/2023-Tax-Strategist-Survey.html>.

About Vertex

Vertex, Inc. is a leading global provider of indirect tax 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 1,400 professionals and serves companies across the globe.

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