

# A CFO's Playbook To Transform the Indirect Tax Function



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Rapid changes in today's global business, technology and regulatory environments are compounding the complexity of indirect tax management and pressuring the corporate tax function more than ever. For instance, the continued growth of e-commerce could fuel more audits. According to the International Trade Association, global retail e-commerce sales have experienced continued and steady 8% growth from 2020 through 2025.

Given this reality, businesses need a firm grasp of tax policies of existing and new markets they serve. What's more, tax authorities also make changes to capture more revenue to meet their funding needs.

“Jurisdictions are making changes and hiring additional auditors to come in to try to get more income into the states because they're missing revenue,” said Larry Mellon, tax director in the Chief Tax Office at Vertex, Inc. “Businesses are being stretched more because now they have to have bandwidth to respond to these audits.”

Jurisdictions in Europe already enforce e-invoicing mandates and real-time tax-reporting requirements as their expedition for transparency increases. No doubt this trend will cross the pond to the U.S. Executing on these obligations can heighten tax-planning challenges, and businesses may be less prepared to address increasing tax risks.

Even if your business has a low chance of being audited, laws or regulations could change.

Whether you've recently acquired a business, incurred penalties in previous audits or undergone a digital transformation initiative to automate your business, keeping pace with the complexity of indirect tax management is crucial to satisfy tax obligations and support growth opportunities.





## Continued Effect of Wayfair Ruling

According to the 2018 South Dakota v. Wayfair ruling, the physical-presence rule is no longer needed to create nexus. Meaning, businesses without a physical presence may still be required to collect sales tax for out-of-state transactions. Almost five years later, nexus challenges continue to intensify as many states have enacted and continue to enact economic-nexus legislation to catch up with how businesses conduct their operations.



While resources such as the Sales Tax Institute’s Economic Nexus State Guide help to determine economic nexus, businesses still need to keep up with ever-changing definitions to ensure they’re interpreting “substantial physical presence” guidelines correctly. Across almost all industries, businesses need to watch out for enforcement and interpretations of physical and economic nexus, such as remote workers, inventory locations, and even where your business holds or attends trade shows.

Other responses to litigation and court rulings could further complicate the way indirect tax needs to be managed. A recent example is Missouri’s enforcement of its economic nexus. Missouri Gov. Mike Parson signed S.B. 153 in 2021, which allowed the state and its local jurisdictions to collect a use tax from qualifying businesses effective Jan. 1, 2023. The state also changed its marketplace-facilitator laws — marketplace-facilitator platforms are now required to collect and remit sales tax for their sellers.

Changes enacted because of the Wayfair decision continue to make indirect tax management harder for many businesses. This is especially so with businesses in states that charge a sales tax and have a limited physical presence in a few other states.





## Complexity in Accurate Mapping

Accurate taxability process mapping doesn't just apply to sound indirect tax management; it's a crucial part of a company's transparency. While business process maps are concerned overall with a company's activities, purpose, and where and when different steps occur, tax management is woven into all parts in a business's financial dealings.





“No financial decision should be made at the company unless the tax department is involved to evaluate the tax impact,” Mellon said.

Companies working with vendors should not only look at whether the vendor is reputable, but the tax department also needs to classify the vendor properly in the ERP system. Say your business uses a landscaping company to mow lawns in the summer and plow snow in the winter. Landscaping services are nontaxable, whereas snow plowing may be taxable in your state. The tax department at your company needs to set up this vendor and its services in the ERP system accurately to ensure that the use tax is assessed correctly. Otherwise, it could become an audit risk and blossom into a more significant problem.

Accurate tax mapping also affects the sales or use tax you charge your customers.

“Businesses should map each customer on the product or service sold and then let taxation fall beyond that,” Mellon said. “It’s essential to be accurate, such as understanding the reason for the product or service, who uses it, and why customers use it.”

Of course, in real life, accurate mapping can get even more complex, especially as jurisdictions continually make taxability changes to product types and use tax accrual. Businesses need to be agile and accurately map their indirect tax obligations in the ERP and in their tax engine to help ensure they’re charging and remitting taxes accurately. The risk is twofold: classifying products incorrectly and applying incorrect or outdated tax rules and rates.



## Risk to Other Businesses

Many businesses don't prioritize indirect tax when it comes to process optimization and digital transformation initiatives. When tax is not part of the scope of those initiatives, the risk can affect both compliance and the bottom line.





Mismanagement of indirect tax can also increase risk to the entire business. Even one small inaccuracy in a filing could have a ripple effect and ultimately result in taxes due as well as penalties. Any discrepancies can affect a company's budget because of unnecessary tax costs.

Aside from increased costs, manual management of indirect tax can prevent you from remaining competitive and launching into new markets. Companies that automate tax processes are more agile and can take advantage of opportunities to expand into new states and countries since indirect tax compliance in new jurisdictions can be easily set up in their systems.

But not all expansion is geographic. Some businesses expand into e-commerce. Without tight indirect tax processes and systems, these companies face an uphill battle to keep up with e-commerce and marketplace compliance regulations, and they risk delivering an inconsistent customer experience across multiple channels.

Mismanaging indirect tax compliance is also a financial risk to your valued suppliers. "If your business gets audited and you haven't accurately mapped your purchases of toilet paper, for example, then the relevant taxing jurisdiction is going to go back to that toilet paper supplier and audit them because the vendor may have also done something wrong," Mellon said. "It's not only a financial risk for your business, it's a financial risk for your vendors based on the work you did or didn't do."

All the above are why it's crucial to include indirect tax in any companywide transformation initiatives and carefully align all financial systems and processes.





## Resource constraints

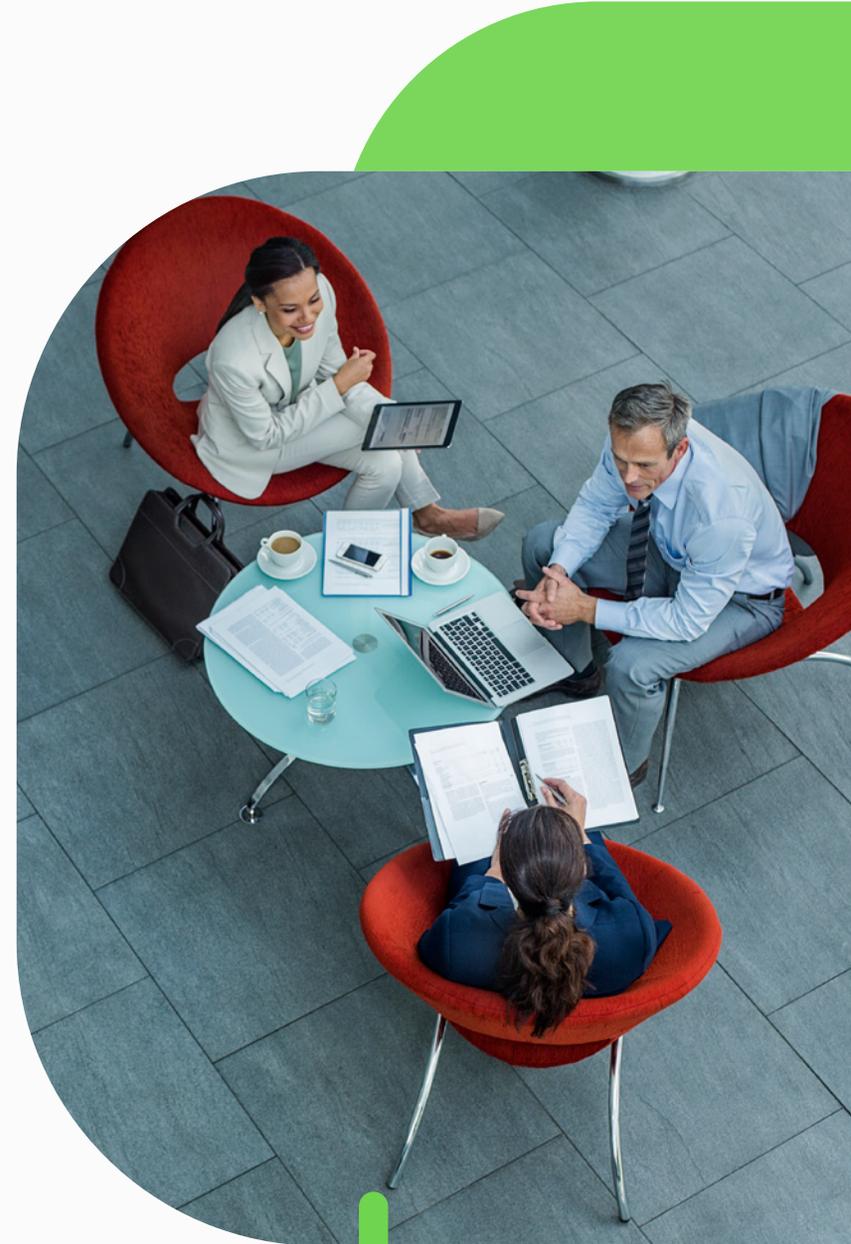
Even if companies want to transform their indirect processes, some lack the internal resources to implement automation and develop new processes to improve efficiency. While data quality is often the culprit, resource constraints can hinder a company's ability to gather, assess and improve that data, which increases the effect of source data errors.





“Businesses without a third-party indirect tax engine can face significant challenges when audited. They need a streamlined reliable source to validate the tax on volumes of AR and AP invoices,” Mellon said.

To reduce reputational and financial risk, cut down on the complexity of accurate mapping, and find ways to keep on top of the continued effects of the Wayfair ruling, a third-party tax engine offers the opportunities to do so. That is, automation or the right technology solution can help your business be more proactive instead of reactive when it comes to preventing errors and supporting growth opportunities.



## The Right Solution

Integrated tax solutions can enable businesses to satisfy tax obligations and support growth opportunities. The right solution can help businesses maintain up-to-date tax content and automate processes to help eliminate human errors as much as possible and remove redundant tasks from the workflow, freeing up time to focus on higher-value analysis, planning and controls. Integrating a tax engine to source financial systems enables management and auditors alike to have faster access to accurate data, and tax staff can ensure products and services are mapped to correct tax categories within the relevant tax jurisdictions. The right technology can also help spot errors and keep on top of the ever-changing indirect tax management landscape.

That said, tax engine implementation should be approached carefully and methodically to support all aspects of the business. And after implementation, indirect tax teams must remain aware of business developments or legal changes that may have tax implications.

“A tax engine can certainly tell you if a new jurisdiction changes their tax decision and can automatically update that information,” Mellon said. “But companies are responsible for mapping their products and services to the correct taxability categories to ensure they’re charging and remitting the correct tax in each jurisdiction.”

Technology should enable better communication across the business and offer more reliable and useful data that ultimately increases the bandwidth of the tax team. Even a lean tax team can be more proactive, such as spotting errors before they happen and fixing discrepancies that come up during reverse tax audits.

Having the conversation now about investing in tax technology cannot be ignored. It’s crucial to calculate this type of investment against revenue, including what your business can save to ensure it’s accurately complying with taxing jurisdictions.



# Staying Ahead of Indirect Tax Management

Current changes have placed increased demand on the indirect tax function and potentially exposed needs and gaps in your current processes that you need to address. Indirect tax management needs to be viewed more holistically since it affects almost all, if not all, areas of a company, whether that's regulatory, compliance, reporting or risk management. In this sense, there needs to be an integrated technological approach to understand and work with your organization's strengths and weaknesses. Using the right solutions can equip finance leadership and tax executives to address indirect tax management demands while positioning their company to tackle future challenges as needed.



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