The Power of One: A New Formula for Addressing Retail Tax Compliance Challenges

The compelling case for a unified commerce capability enabled by Shopify, Vertex and EY

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The retail industry's indirect tax compliance challenges keep adding up.

Regardless of whether a retailer files sales and use tax (SUT), value added tax (VAT) or another goods and services tax (GST), maintaining tax compliance resembles a cumbersome math problem featuring an endless array of addition: more tax rules and rate changes; more (and more exacting) customer expectations; more sales channels; more tax exemptions; and more sales, procurement and accounting systems.

Fortunately, there is a tried and tested solution, one that leverages the power of one: a unified commerce capability powered by Shopify, its seamless integration with Vertex's tax engine, and implementation support from EY.

Getting this solution in place requires:

- An understanding of industry trends that create tax compliance difficulties;

- A matter-of-fact look at the fragmented teams, processes and supporting technologies that complicate complexity;

- Partnership with a third-party implementation services provider that recognizes the critical value of comprehensive requirements-gathering and testing; and

- The use of leading implementation practices.

Three Flavors of Industry Trends, Threats and Opportunities

Social media channels, cost pressures, smart mirrors, marketplace facilitator tax rules, retail stores as fulfillment centers, edge computing, split shipments, endless aisles...

Cataloguing all of the retail trends and challenges with tax compliance implications quickly feels like an endless exercise, so it's helpful to group these risks and opportunities into three buckets:

1. **Consumer behaviors:** Retailers' responses to rapidly changing customer preferences have repercussions on tax compliance. Curbside pickup, BOPIS and BORIS deliver convenience to discerning consumers and can improve the customer experience; yet, these offerings also make tax determinations more difficult. The adoption and maturation of e-commerce also poses compliance challenges (e.g., accessing and managing tax-relevant data across numerous commerce teams and technology systems).

2. **Legislative and jurisdictional changes:** Indirect tax rates change frequently as countries, states, cities and other taxing districts respond to economic swings and budgetary pressures. Tax and fee-related legislative actions require changes to compliance processes and supporting technology. "Businesses are struggling to implement the right data strategy and technology needed to cope with the emerging legislative and regulatory requirements," according to EY's 2024 Tax and Finance Operations Survey.[1] The EU's massive VAT in the Digital Age (ViDA) reform package calls for new e-invoicing, real-time reporting requirements, even as individual EU Member States promulgate their own e-invoicing and real-time reporting mandates. In the U.S., states are enacting retail delivery fees, environmental fees and airport fees to generate revenue; and tax groups bear the brunt of the growing fee-compliance burden.[2] State legislators have also enacted a flurry of sales tax exemptions, placing greater pressure on retailers' exemption certificate management capabilities. And marketplace facilitator laws, which determine which parties are liable for tax, continue to evolve.

3. **Strategic business initiatives:** Business growth – whether it involves geographic expansion, new product lines, new services bundles, or new sales channels – requires adjustments to tax compliance processes and systems. Cloud migrations, the implementation of new systems and advanced tools (e.g., artificial intelligence), also affect tax compliance and tax automation solutions.

These advancements will continue in the future as more retailers:

- Adopt and advance AI capabilities, social media selling, and in-game shopping

- Initiate holiday season promotions earlier to sidestep supply chain delays

- Invest in circular economy offerings

- Extend their use of delivery services to more product categories

- Enhance their focus on experiential offerings

- Embrace direct-to-consumer models

The Unified Commerce Imperative

Stroll through the back offices of most retailers, and you'll likely discover distinct online and in-store groups, disparate inventory-planning and pricing teams, and a jumble of supporting systems and applications. These circumstances impede the flow of transactional and customer data among different commerce units – and to finance, accounting and tax groups. Plus, information-sharing challenges can be exacerbated by remote and hybrid working models. This friction often comes to a head when different commerce groups collaborate on a new initiative, such as enabling order fulfillment in store locations, selling gift cards online, or implementing surge pricing.

Process and systems fragmentation has downstream implications on tax teams and their accounting counterparts. Sometimes, tax groups first learn about a commerce-related improvement with major tax compliance implications after the new capability is live.

As such, it helps to bring all sales channels under one roof from an automation perspective. "Technology underpins how retailers can claim an advantage in customer insights, functional integration, distribution, real estate and inventory management," according to EY. "Do you have an e-commerce function, or a unified strategy integrated with stores for seamless experiences, better economics and greater customer lifetime value?"[3]

Shopify's out-of-the-box tax features enable retailers to develop a unified commerce function and to quickly start selling, online and/or in-store while easily scaling to support domestic and global business. Integrating the Vertex tax engine with Shopify's platform enables tax groups to keep pace with business growth and fluctuating tax rates and rules.

> "When you visit a retailer's offices, you often discover that separate groups are responsible for in-store and retail sales. They each have their own systems as well as dedicated merchandising teams, inventory planning teams and pricing teams. When you bring all of your sales channels onto a single, unified platform, those groups need to collaborate effectively."
>
> Brian Edwards,
> Retail Partnerships Manager,
> Shopify

Business Case Focal Points

Tax should be involved in e-commerce platform implementations; the group's insights on compliance requirements limits the need for costly adjustments once the implementation is complete.

Tax leaders' involvement also gives them an opportunity to make the case for a concurrent tax engine implementation. Successful tax automation business cases quantify a comprehensive set of costs and benefits while emphasizing the following factors:

1. **Audit exposure:** It helps to assess the company's audit exposure due to improper tax determinations, calculations and collections.

2. **Customer satisfaction:** The speed and accuracy of tax calculations and the accuracy of tax exemptions both affect the customer experience. Tax determination errors can create the need to return to collect taxes from customers long after the fact. Less palatable implications, including class action suits, arise when retailers collect taxes on transactions that should have been treated as exempt.

3. **Unnecessary rework:** Compliance errors also require costly and time-consuming cleanup work in tax and accounting groups: invoices must be tracked down and replaced, accounts must be credited, refunds must be issued and taxes must be collected.

Requirements, Testing and other Implementation Priorities

E-commerce and tax engine implementations that generate the highest ROI tend to elevate the importance of requirements-gathering and testing. EY prioritizes those activities with a handful of other leading implementation practices, such as:

- **Striking an optimal IT-tax balance:** Implementing a tax engine requires an optimal mix of tax and IT considerations. When the implementation veers too IT-centric, tax decisions are often made based on technology requirements as opposed to compliance realities. Overly tax-driven projects tend to collide with technical limitations.

- **Understanding business processes and workflows:** Beyond tax and IT, it's important to get all of the project's stakeholders in the same room to discuss and understand each group's capabilities, drivers and limitations. These sessions should closely examine the tax implications of sales processes and programs. *How do promotions, discounts, product bundles sold as a single unit, and warehousing decisions affect tax determination?*

- **Addressing requirements as comprehensively as possible:** Collecting a complete set of requirements hinges on the project team's ability to identify how the company truly conducts business.

- **Conducting thorough testing:** The more the project team tests the new e-commerce platform and integrated tax engine, the higher the returns will be on those investments. Finding a larger number of issues during the testing phase is not a problem, but an opportunity to reduce future rework, costs and audit exposure.

"There are two things that third party implementation firms tend to be very good at: focusing on requirements and testing. If you don't address all of your tax requirements or if you're testing is insufficient, you'll discover issues later on that negatively affect compliance and your audit exposure."

Rafael Diefenthaeler, Principal, Indirect Tax Technology and Transformation, EY

"When it comes to home improvement, there are some smaller things around the house that I can fix. But for more complicated projects, I'm calling a specialist. The same holds for a tax engine implementation. If you want it completed in a correct, complete and timely manner, you should consider calling third party system implementation firm."

Pete Olanday, Director, Retail Consulting, Vertex

External implementation firms prioritize those activities, while equipping client organizations with:

- Systems implementation expertise and firsthand knowledge of best practices;

- Resources (when retailers are unable to sufficiently staff the project team); and

- Retail industry experience and know-how, earned from similar project work with many of the industry's leading companies.
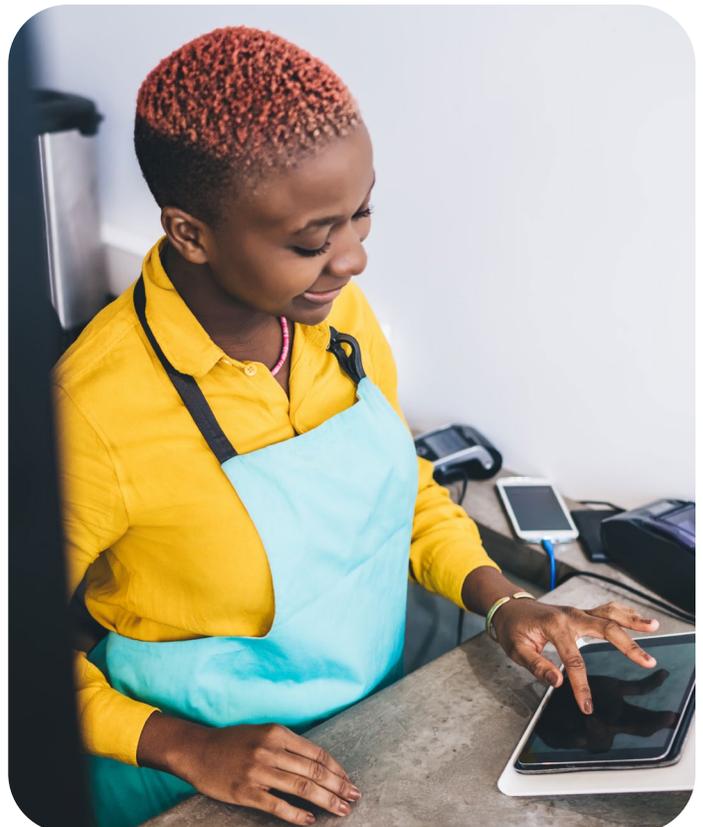
Conclusion: Measure Up

Another leading practice relates to the measurement and monitoring of the e-commerce platform and integrated tax engine after their launch. Project teams should define these KPIs during the implementation after requirements have been finalized.

While these KPIs vary based on each retailer's strategic objectives, measures related to the tax engine's performance center on the ease, accuracy and scalability of the tax compliance capability. These measures tend to quantify benefits related to data management, data quality, error rates and customer experience. The e-commerce platform's performance also warrants measuring and monitoring. These KPIs may calculate business growth, time to market and product-line expansion.

The value generated from an e-commerce platform integrated with a tax engine also adds up quickly. That makes it important for commerce, tax, finance and IT groups to agree on the right formula for a successful implementation.

End Notes

[1] https://www.ey.com/en_gl/insights/tax/tfo-survey.

[2] https://www.vertexinc.com/resources/resource-library/three-ways-reduce-fee-compliance-burdens.

[3] https://www.ey.com/en_us/insights/transforming-retail/five-components-to-fortify-omnichannel-retail.

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