A Brave New World of Retail Tax Challenges

Asking the Right Questions Can Eliminate Tax Automation Uncertainty

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Deloitte's 2016 Global Powers of Retailing report focuses on the struggles and successes retailers encounter while navigating the complexities of digital transformation. While this effort is formidable, it is just one of many major challenges that retail companies and their tax functions confront.

"In the world of retailing, much attention has lately been focused on the competitive threat to stores coming from online retailing, the challenge of cybersecurity, and the difficulty in deciphering the tastes and price sensitivities of an increasingly fragmented consumer market," the report reads. "Yet through all of these and other issues, one thing remains constant. That is the considerable impact on retailers of economic strength and weakness, of inflation and deflation, and of currency and asset price movements."[1]

Although this combination of challenges sounds imposing, there are even more. The drivers of change affecting retail companies include the hectic pace of consolidation, the ongoing march of globalization, ever-increasing regulatory activity, the explosion of e-commerce and multi-channel consumers, and growing technology complexity. Technology advancements pose risks as well as opportunities. Retailers must vigilantly protect customers' personally identifiable information (PII) while implementing stronger credit card security controls.

The rise in technological complexity is driven by the rapid consumer adoption of smartphones and tablets, as well as the increasing use of social media. It is also driven by internal factors, including the proliferation of customer data (and the adoption of analytical tools that seek to harness big data), merger and acquisition (M&A) activity, which adds new legacy information systems to the mix, and the adoption of cloud technology in the form of hosted systems and software as a service (SaaS).

It is also clear that retail companies and their tax functions face a growing need for innovative, comprehensive and unique tax management solutions to navigate the current environment. While there is growing acceptance of the need for tax automation, there also exists a growing sense among retailers that not all tax automation solutions are created equal.

The purpose of this article is to help retailers find the *right* tax automation solution. This capability requires an understanding of sources of the industry's changes, the implications of these changes, and the types of questions that can help tax and technology executives identify a solution that meets their needs.

Drivers of Change—and Tax Challenges

The retail industry's ongoing transformation is driven by many interconnected forces, including:

M&A activity: M&A activity in the retail and consumer sector remains robust. During the first three months of 2017, the U.S. consumer markets sector posted its heaviest deal activity in the past decade, according to PwC.[2] Consolidations often bring with them new tax compliance and/or tax calculation requirements. For example, through an acquisition, the acquiring company may gain nexus in other states. Mergers also tend to intensify an organization's information technology (IT) and tax data management complexity by adding new systems and applications to manage within the IT environment.

Global expansion: Globalization's onward march continues as retailers seek new markets, especially among emerging economies with rapidly growing populations of middle-class consumers. This quest also leads to relationships with new trading partners as well as new acquisitions. Retail experts expect this trend to continue as retailers enter more and more markets. From 2001 to 2016, the developing world population increased 21 percent; during that same period, retail sales in developing markets increased by more than 350 percent, according to consulting firm AT Kearney[3]. This expansion exposes companies to new tax jurisdictions, tax calculations, compliance challenges and risks. Despite the opportunity of selling abroad, online retailers are often reluctant to expand due to the cost of managing this additional complexity. Selling internationally also requires understanding and complying with e-commerce rules and requirements within each country in order to design the most efficient fulfillment strategy. Finally, global expansion can be daunting when considering foreign currencies, customs duties and complex value-added tax (VAT) rules. This is especially the case in

Europe right now. In 2015, new European Union (EU) regulations changed how VAT operates for business-to-consumer e-commerce. While the additional rules and clarifications are consistent among EU member countries, these regulations are "very complex to operate," according to the Centre for Retail Research. Under previous regulations, VAT was charged at the rate applying in the country of the seller. Now, retailers are required to apply the VAT rate of the country where the consumer is located. That is the high level summary; the new regulations are detailed and contain a number of specific reporting requirements, according to the Centre for Retail Research: "The new system is consistent, but is administratively burdensome with many petty calculations and specific requirements needed to pass the inevitable audits."

Regulatory complexity: In addition to the tax challenges posed by global expansions, U.S.-based retailers face extreme challenges in their efforts to comply with increasingly complex state and local tax regulations at home. These challenges relate to other drivers of change and include difficulties related to managing the taxability of multi-channel transactions, exposure to audits often experienced by high volume transaction businesses, coverage for unique compliance requirements associated with jurisdictional special tax rates and rules, and ongoing—and often changing—compliance requirements.

E-commerce and multi-channel growth: Traditional retailers are well aware of the impact of e-commerce on the competitive landscape. U.S. e-commerce sales in 2016 reached $394.9 billion, an increase of 15.1 percent compared to 2015, according to the U.S. Census Bureau.[5] As the growth of e-commerce continues, retailers now must adapt to the rapidly growing use of mobile devices by shoppers. Increasingly, multiple channels are used to complete a single transaction. For example, shoppers can buy a product on their smartphone and later that day pick up the purchase from a nearby retail outlet. Alternatively, a consumer can purchase an item online and later decide to return the item to the retailer's physical store. Or, shoppers may purchase an item while on vacation and have the retailer ship it to their home location (i.e., send sales). These behaviors have major tax implications. Sales and use tax is crucial to multi-channel integration, and must be accurately and consistently calculated across all channels.[6]

Technological complexity: As a result of the forces and changes described above, many retailers manage numerous information systems. These include multiple point of sale (POS) systems, e-commerce systems, enterprise resource planning (ERP) systems and much more. Tax data flows through many of these systems and applications – and onto a growing number of mobile, handheld devices and related technology (e.g., radio frequency identification, 3D printing and even biometrics) as well. These systems and devices increasingly interact with each other, creating a dynamic that can provide substantial benefits (such as more sales), but significant tax risks as well. One way to manage technological complexity is by maintaining a single, central source of tax automation.

Asking the Right Questions about Tax Automation

Leveraging tax automation offers retailers several benefits. Customer satisfaction increases when tax calculations accurately occur in the background without their involvement. Risk management is strengthened because auditors can easily see that transactions were handled correctly, which reduces the risk of lawsuits and negative publicity that arise in the wake of major accounting and tax errors. Tax compliance professionals gain better visibility into transactions while more accurately calculating tax on sales transactions. Tax professionals benefit by being able to devote more time to their strategic contributions to the company, rather than spending time tracking down tax data all over the enterprise.

Tax automation also delivers confidence that tax requirements are being met while serving as a foundation for more efficient and effective compliance, resulting in reduced audit exposure.

While most of these benefits can potentially be found in any tax automation tool, not all forms of tax automation are equal. And certainly not all tax automation solutions can address the growing magnitude and complexity of tax issues within the quickly changing retail industry.

To find a uniquely equipped solution that is mindful of all of these challenges, it helps to ask questions in the following categories:

- **Scope and Scale**: Does the solution address multiple points of sale for a diverse range of products and services? Can the system operate as an enterprise tax solution? Can the system grow with the organization so that it can support current sales channels, back office processes, and global expansion? Can the solution accommodate quick and unexpected business growth, including adding new store fronts, expanding into diverse lines of business that generate new tax obligations, and expanding into new global geographies? Tax automation solutions need to keep up with the pace of change in new channels and markets.

- **Flexibility**: Does the solution offer deployment options that are compatible with existing POS, e-commerce and back office systems? How effectively can the solution integrate with all relevant systems? Can the system be scaled in a way that mitigates any risk associated with the operation of mission critical sales processes? Finally, does the solution offer the added flexibility for SaaS as an alternative option to on-premise installation?

- **Consistency**: The tax solution should deliver consistent tax calculation results, regardless of which sales channel is used. Consumers need to be charged the correct tax rate whether they buy an item in a physical store or online—regardless of whether those rates are the same or differ. Accuracy is paramount.

- **IT Performance and Fit**: How well will the solution complement the IT environment without creating business disruptions? Does the system provide options for IT colleagues so they can support a tax automation process that reduces IT's overall maintenance and support effort? Achieving an integrated retail platform needs to start with the consideration of business processes, applications and underlying infrastructure to maximize value.

- **Content**: Does the solution provide accurate, timely and relevant tax rates, rules, rounding, overrides, reporting drivers and add-on fees? Does the solution help address any current tax gaps (neglecting tax holidays, compound and threshold rates, and other rules)?

- **Auditability**: Can the solution provide convenient, comprehensive access to audit-related data requests? For example, does the solution provide integrated exemption certificate management to support audit defense?

- **Opportunity Cost of Tax**: To what degree can the solution help liberate tax professionals from data collection activities so that they have more time to contribute to higher value activities?

- **Cash Reserves**: Can the solution help the bottom line by substantially lowering the amount of cash reserves the company maintains to combat risks of non-compliance and tax audits?

To be sure, this rundown of questions is representative rather than comprehensive. The purpose of these questions is to maximize the return on investment (ROI) in tax automation. The application of these questions will ensure that the tax automation evaluation process that retailers conduct is more comprehensive and, ultimately, more effective in identifying the right solution.

While the retail industry continues to evolve, tax must also keep pace. Technology plays a key role in enabling tax professionals to manage many drivers of change, from regulatory complexity to omni-channel growth and global expansion.

Endnotes

[1] "Global Powers of Retailing 2016: Navigating the new digital divide." Deloitte (2016). Retrieved from https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Consumer-Business/gx-cb-global-powers-of-retailing-2016.pdf.

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[3] "The 2016 Global Retail Development Index™ Global Retail Expansion: An Unstoppable Force," A.T. Kearney, Inc. (2016). Retrieved from https://www.atkearney.com/documents/10192/8226719/Global+Retail+Expansion+at+a+Crossroads%E2%80%932016+GRDI.pdf/dc845ffc-fe28-4623-bdd4-b36f3a443787.

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[6] Olanday, Pete (May 2016). "Sales Tax Management Essential to Retailers' Omnichannel Success." Retrieved from http://www.vertexinc.com/ResourceCenter/pdfs/Final%20Vertex%20Retail%20Sales%20Tax%20Essential_White%20Paper_DSB_Review_v3.pdf.

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