REDUCING THE IMPACT OF SUT COMPLIANCE IN THE NEW RETAIL ENVIRONMENT

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Report Highlights

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The top challenge for retailers in SUT compliance is managing tax over multiple locations.

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Leaders achieve 98% filing accuracy compared to 86% for Followers.

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Leaders are 56% more likely to have a complete Sales and Use Tax compliance solution.

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Retailers with SUT solutions saw significant improvements in the amount of time spent on individual tax workflows such as research, filing, and data reconciliation as well as the amount of time it takes to complete an audit.

This report reveals the unique challenges that retailers face today in indirect tax, and provides a roadmap for ensuring compliance in their new business environment.

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For today's retailers, operating across multiple locations, online sales, and varied and changing mandates across jurisdictions is a recipe for disaster in SUT compliance. Retailers are spending a significant amount of time and money attempting to keep up, and many are still ineffective.

Sales and Use Tax (SUT) compliance is uniquely challenging for retailers in the new business environment they find themselves in. The combination of physical presence and geographic expansion, along with rapidly expanding product assortments, shipping, and fulfillment models brought about by maturing e-commerce models, drives rapid business evolution. These increasing business changes collide with complex and rapidly changing compliance obligations, leading to much confusion and many mistakes.

Unfortunately, regulators do not offer leniency due to degree of difficulty. In fact, regulatory bodies are only becoming more aggressive. In a recent study, 39% of retailers stated that audit scrutiny and frequency has increased over the past two years. Even scarier, another 48% believe that audit frequency and scrutiny will continue to increase over the next three to five years.

While SUT compliance has long been a challenge for retailers of all sizes due to their complexity, these trends can be particularly concerning for the mid-market. Almost half of retailers earning between $100 million and $1 billion in annual revenue have seen an increase in audit scrutiny and frequency over the past two years. For this segment, SUT compliance and audit issues can hinder growth, as the organization must expend resources that could be better spent elsewhere, as well as proactively prepare for unfamiliar compliance obligations that could delay the launch of new products or entry into new markets.

For these reasons, SUT compliance is a substantial issue that must be addressed for retailers of all sizes. This report reveals the unique challenges that retailers face today in indirect tax, and provides a roadmap for ensuring compliance in their new business environment.

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In this survey, respondents fell into the following demographics:

- **Function:**
  - Tax: 41%
  - Finance: 36%
  - IT: 36%
  - Tax: 22%
  - Other: 7%

- **Title:**
  - C-Level, VP (functional head): 36%
  - Director, Manager, Controller (department head): 33%
  - Specialist, Analyst, Manager (department team member): 30%
  - Other: 2%

- **Revenue:**
  - More than $2 billion: 19%
  - $1 billon to $2 billion: 9%
  - $500 million to $1 billion: 12%
  - $100 million to $500 million: 16%
  - $50 million to $100 million: 9%
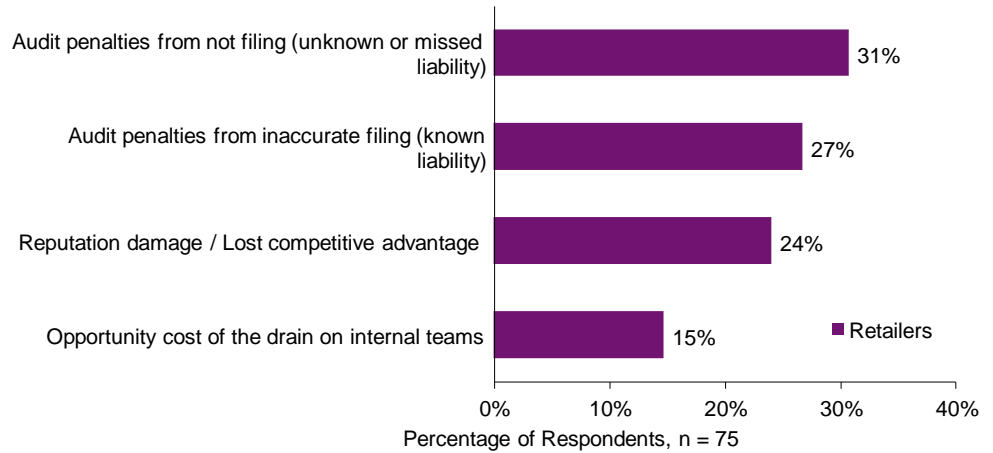 - Under $50 million: 34%

The Retail SUT Environment

For today's retailers, the current regulatory environment is fraught with risk. Survey takers were asked to indicate the biggest risk to their organization that their current SUT process poses (Figure 1). Retailers face a significant risk of audit penalties for both how accurate they as well as and how knowledgeable they are about where and how they should be filing. This risk stems from the fact that many retailers just do not fully understand their obligations when managing SUT compliance. In fact, 31% of respondents indicated that the biggest risk to compliance is penalties from not filing in jurisdictions where they should be.

This indicates that rapid business and regulatory change has outpaced the capacity of many tax teams and their technologies. Inconsistent and evolving mandates related to online sales, as well as varied rules across multiple jurisdictions that frequently change, are significant challenges for tax and IT teams to stay on top of. This risk will not only impact the bottom line, but non-compliance can also hinder the organization from competing in certain markets, as well as put a considerable strain on internal resources as they attempt to keep up.
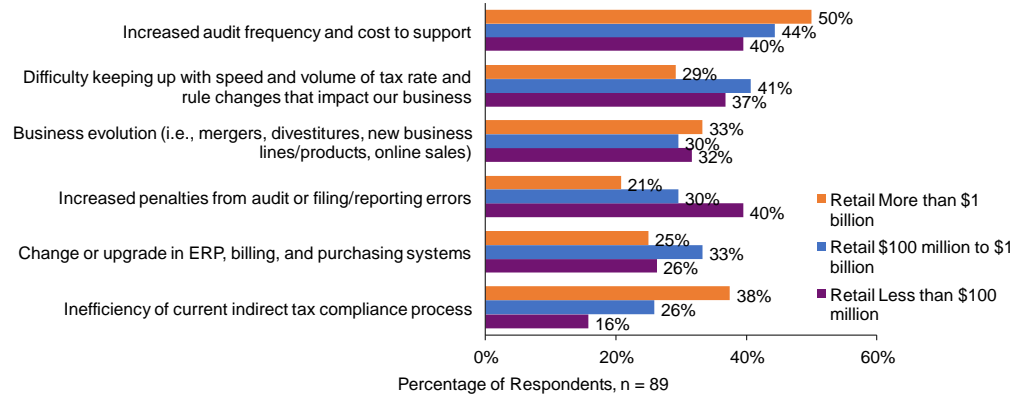
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Figure 1: Biggest Risks in SUT Compliance

Audit penalties from not filing (unknown or missed liability)	31%
Audit penalties from inaccurate filing (known liability)	27%
Reputation damage / Lost competitive advantage	24%
Opportunity cost of the drain on internal teams	15%

■ Retailers

Percentage of Respondents, n = 75

Source: Aberdeen Group, April 2017

Retailers must do all they can to avoid these risks. Unfortunately, they are faced with a series of challenges that make avoiding these risks difficult. Survey takers were asked to indicate their top three challenges when it comes to SUT compliance (Figure 2). These challenges are centralized around the fact that SUT compliance forces retailers to spend time and money ensuring that compliance is achieved due to the harmful impact of non-compliance. These organizations are expending time researching tax changes, responding to auditors, updating business systems, and performing tax workflows themselves. In the face of a rapidly changing retail market, these time-consuming tasks are a major burden.

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Figure 2: Top SUT Compliance Challenges

	Retail More than $1 billion	Retail $100 million to $1 billion	Retail Less than $100 million
Increased audit frequency and cost to support	50%	44%	40%
Difficulty keeping up with speed and volume of tax rate and rule changes that impact our business	29%	41%	37%
Business evolution (i.e., mergers, divestitures, new business lines/products, online sales)	33%	30%	32%
Increased penalties from audit or filing/reporting errors	21%	30%	40%
Change or upgrade in ERP, billing, and purchasing systems	25%	33%	26%
Inefficiency of current indirect tax compliance process	38%	26%	16%

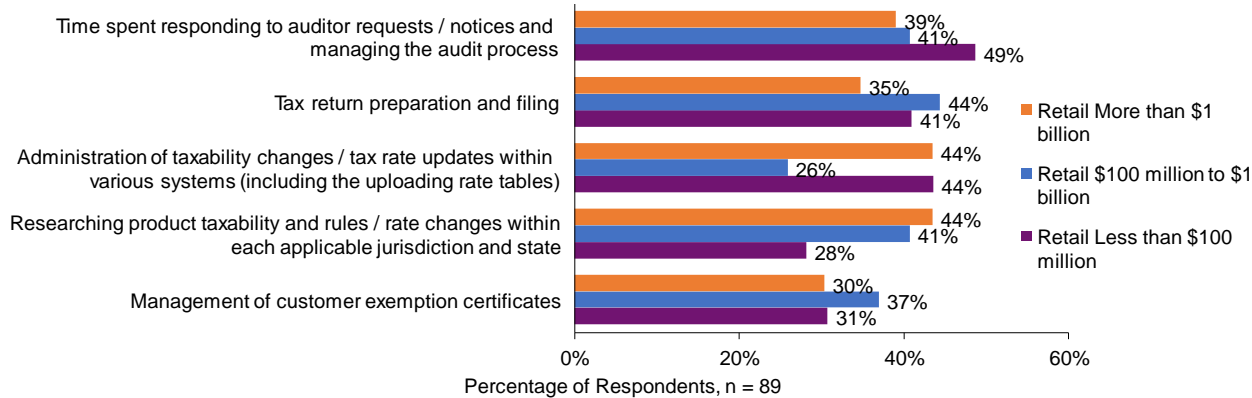Percentage of Respondents, n = 89

Source: Aberdeen Group, April 2017

Truly, the challenges listed above put significant strain on today's retailers (Figure 3). There are many individual aspects that eat into resources that could be utilized for other, value-added tasks. Tax professionals spend an unending amount of time researching changes to tax rates across many jurisdictions, then IT professionals must implement and test those changes in the technology that the business uses. Additionally, there is the management of the tax process itself, as resources must be expended to perform tasks such as preparation, filing, and the management of exemption certificates.

Further, as retailers are audited, they must deal with the time-consuming burden of gathering data and preparing it for the auditor, which is particularly challenging for small- and mid-sized retailers with fewer resources. Managing all of these tasks costs money in both the resources themselves as well as the opportunity cost of diverting resources from other value-added tasks, not to mention the potential penalties.
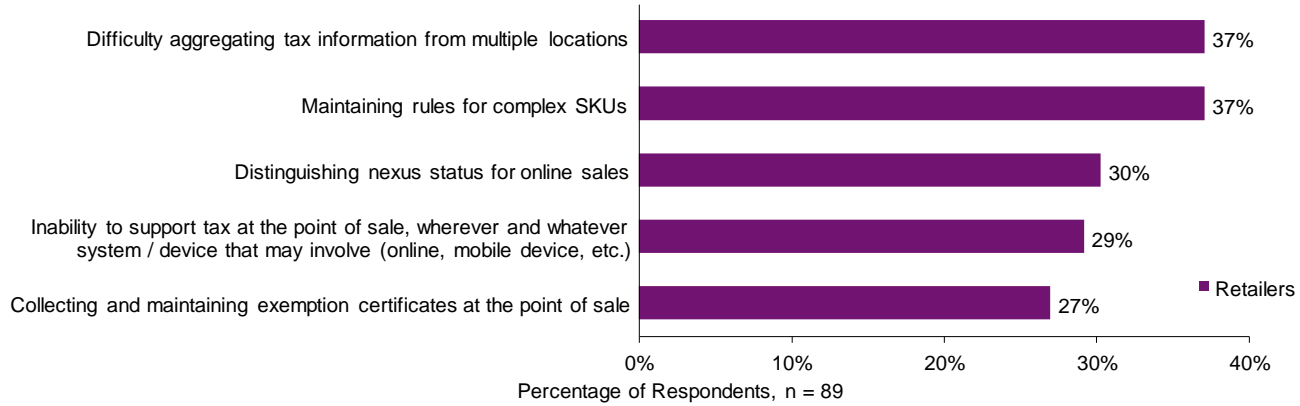
Figure 3: Biggest Drains on the Business

	Retail More than $1 billion	Retail $100 million to $1 billion	Retail Less than $100 million
Time spent responding to auditor requests / notices and managing the audit process	39%	41%	49%
Tax return preparation and filing	35%	44%	41%
Administration of taxability changes / tax rate updates within various systems (including the uploading rate tables)	44%	26%	44%
Researching product taxability and rules / rate changes within each applicable jurisdiction and state	44%	41%	28%
Management of customer exemption certificates	30%	37%	31%

Percentage of Respondents, n = 89

Source: Aberdeen Group, April 2017

Digging deeper into exactly why it is difficult to complete tax workflows effectively, survey takers were asked to indicate the top two challenges in SUT compliance that impact retailers specifically (Figure 4). Many of these challenges stem from having a geographically dispersed organization with many locations. Individual locations will have differing rates and rules that must be applied over large numbers of complex SKUs at the point of sale. Further, working to create a truly seamless "omni-channel" experience for customers presents an ongoing challenge, as retailers attempt to distinguish nexus status and manage compliance across numerous jurisdictions. in the new regulatory environment. Truly, today's retailers face increased unique challenges in managing SUT compliance from all directions as they expand into new business channels and technologies in order to meet consumer demands.

Figure 4: Top Challenges for Retailers

Source: Aberdeen Group, April 2017

All of these struggles influence the performance of a wide variety of Key Performance Indicators (KPIs) that successful organizations monitor when measuring SUT compliance. Survey takers were asked to identify their performance across a wide variety of metrics (Table 1). Today, on average, retailers are spending a significant amount of time on audits, indicating consistently inaccurate or late performance on returns that can result in paying substantial fines.

Table 1: Performance

Metric	Performance
Number of audits over the past 5 years	> 30
Days to prepare for and complete an audit	8.1
Average penalties paid when audited	$47,063
Percentage of revenue spent on penalties due to filing errors	1%
Returns that were 100% accurate over the past two years	73%
Filings that were late over the past two years	17%
Employees used to manage compliance	12.1

Source: Aberdeen Group, April 2017

Note how many employees are typically used to manage compliance. When you multiply the number of employees by the number of hours they spend on the individual steps of SUT compliance, it is possible to understand just how much an organization spends on these tasks (Table 2). It is interesting to note the amount of time spent on technology; IT is often a hidden cost of SUT compliance. In fact, on average, respondents to the survey from the IT function replied that each of these tasks take longer than their tax and finance colleagues. It is also worthy to note that in many cases, the amount of time dedicated to each part of the process is not producing optimal results. As retailers examine strategies for improvement, they will need to weigh the benefit of increased time allocated to the process and technology.

Table 2: Hours Per Employee Per Month

Task	Hours
Researching tax rates	4.5
Management reporting / analysis	6.6
Filing / remittance	8
Reverse audits and recovery	3.9
Data reconciliation	6.2
Technology infrastructure updates / maintenance	4.4
Preparing / managing audits	6.8

Source: Aberdeen Group, April 2017

Truly, the SUT compliance environment for retailers is varied and complex. To minimize the impact of the compliance drain and audit risk, retailers must adjust their SUT strategies to become more effective and efficient.

Leading Strategies for SUT Compliance

Retailers that are effective at managing SUT compliance perform better in the metrics outlined above (see sidebar). In order to achieve this performance, it makes sense to emulate the actions of these "Leaders." When asked to indicate their top two strategies, the Leaders began to outline their recipe for success (Figure 5).

In this report, Aberdeen groups respondents into two maturity classes:

- **Leaders:** Top 35% of respondents based on performance

- **Followers:** Bottom 65% of respondents based on performance

Figure 5: Top Strategies

Source: Aberdeen Group, April 2017

In this report, respondents were ranked on the following criteria:

- **Percentage of returns that were accurate over the past 2 years:**
  - Leaders — 98%
  - Followers — 86%

- **Percentage of filings that were late over the past 2 years:**
  - Leaders — 5%
  - Followers — 26%

- **Change in the amount of time spent managing compliance over the past 2 years:**
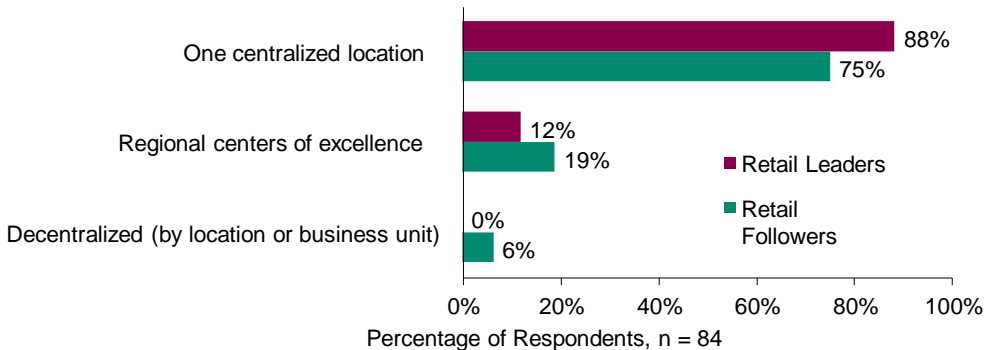
  - Leaders — 1% decrease
  - Followers — 10% increase

Leaders have prioritized process and technology improvement when it comes to SUT compliance. First, they look to make improvements in the way they handle preparation, filing, and remittance. They do this by beefing up their capabilities, including the internal resources necessary and the technology that can enable them. Through technology, Leaders can cost-effectively automate and streamline processes to ensure accuracy of rates and rules, and improve the accuracy and timeliness of filing. Additionally, they can improve communication with auditors to both improve relations as well as reduce the amount of disruption related to this burdensome process. In order to do all this, Leaders audit their existing processes and technology to ensure that they achieve compliance effectively, without putting too much strain on the business. Ultimately, it's about confirming accuracy with as little impact to ongoing operations as possible.

Another essential component of a SUT compliance strategy for larger retailers is how tax resources are deployed across the organization. For a geographically distributed retailer with different business units or brands, managing tax compliance location to location can be cost-prohibitive and lead to inferior performance.

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Instead, Leaders are 17% more likely to centralize SUT compliance in a shared services center (Figure 6). By centralizing, retailers can invest in one single set of resources and technologies, rather than having to duplicate them across many locations. The company can invest in one knowledge set and ensure that standards are followed, and that the same processes and methods are used across all business systems and transaction types. This pairing of centralized expertise and compliance technology ensure accurate calculations, streamlined data processing, and accurate filing as the organization expands. A centralized process also reduces risk and enables more efficient and effective audit defense.

Figure 6: Centralizing Compliance

Source: Aberdeen Group, April 2017

To support their strategies of centralization and process improvement, Leading retailers are more likely to have implemented a wide variety of tools that assist in SUT compliance (Figure 7). These include individual functionality, such as automated features for evaluation, exemption management, calculation, filing, remittance, and recovery. Each of these individual functions can ensure that rules are followed, accurate
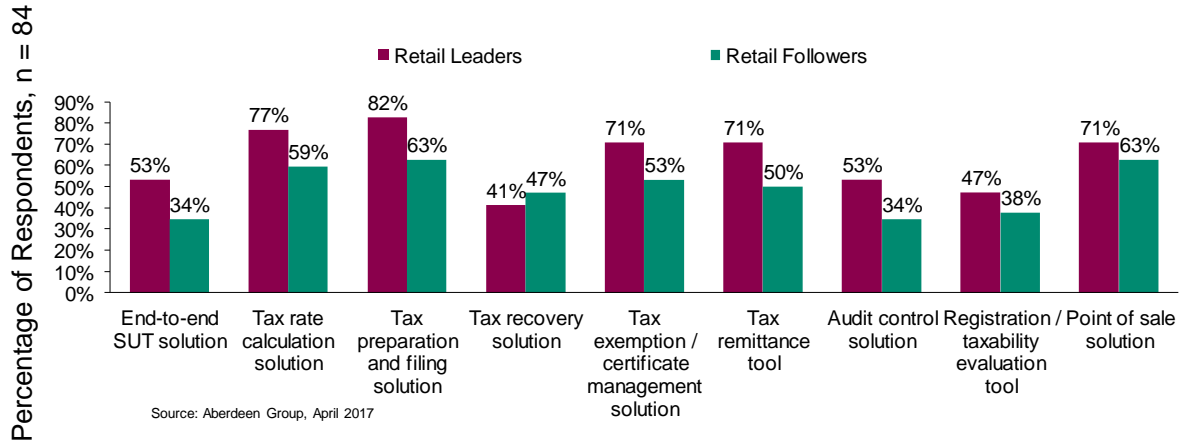
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data is utilized, and efficiency is maintained throughout every step of the SUT compliance management process.

Even further, Leaders are more likely to have a complete SUT solution that combines all of this functionality, which creates a seamless process that is critical in preparing for and managing audits. By investing in one comprehensive and purpose-designed technology, tax professionals will get a solution that supports their needs from end-to-end, in a package that is easier to implement and more cost-effective to manage. There is a smaller impact on internal resources, helping to keep the cost of compliance lower. They can rely on the software vendor to keep the technology up to date with changes to tax laws, and will gain the confidence they need when managing tax; otherwise, what these organizations do not know could be hurting them.

While a larger percentage of organizations without an SUT solution say that they don't know if there are jurisdictions they should be filing in where they are not, those with solutions are more likely to be aware of their mistakes. Thirty-nine percent (39%) of those with SUT solutions state that they are aware of jurisdictions that they should be filing in that they are not — in comparison to only 5% of those without solutions. This shows that these solutions help retailers improve performance while also providing the capacity and tools to better understand the tax requirements in their varied and complex regulatory environment.

Figure 7: Leaders Look to Complete Solutions

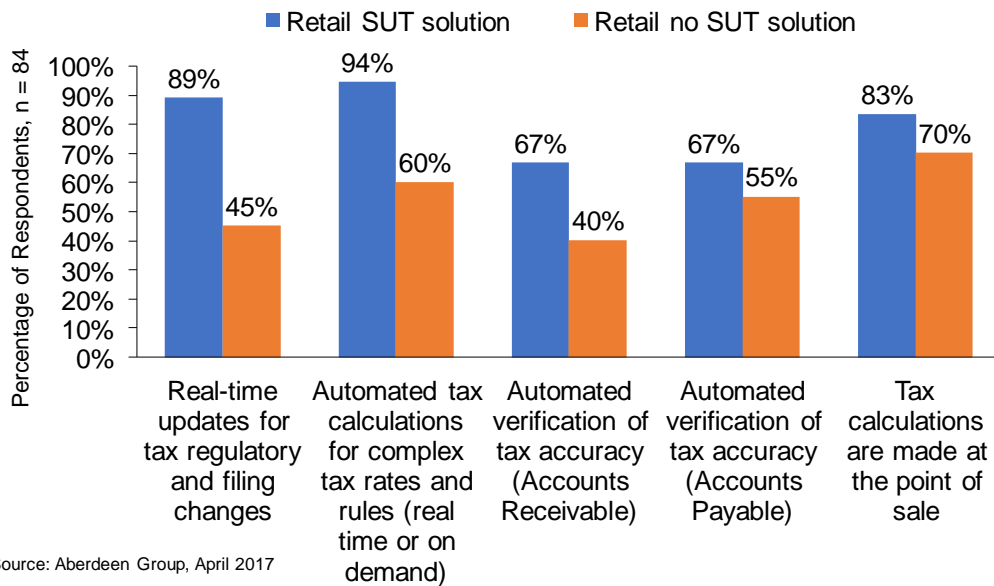Source: Aberdeen Group, April 2017

By relying on the capabilities of their software vendor, Leaders show a propensity to have a number of key capabilities that lead to superior performance. As indicated in Figure 7, Leaders are more likely to have a full end-to-end solution that consists of several key elements, including product taxability, tax rate calculation, tax preparation, exemption certificate management, and filing and remittance. These integrated capabilities ensure that compliance workflows are completed accurately and efficiently. This is evidenced by comparing the tax compliance capabilities of retailers with SUT solutions to those without. First, these solutions enable retailers to ensure that they are acting in accordance with accurate and up-to-date mandates across all of the jurisdictions where they operate.

Traditionally, research has been a confusing and time-consuming component of managing SUT compliance. Instead, those with SUT solutions are 98% more likely to have real-time updates for tax regulatory and filing changes (Figure 8). This reduces the time burden on resources and sets the foundation for future compliance, because without this capability, the onus is on internal

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tax, finance, and IT teams to do the research, stay on top of changes, and administrate timely updates across all of their transaction processing systems.

Figure 8: Automation Ensures Accuracy

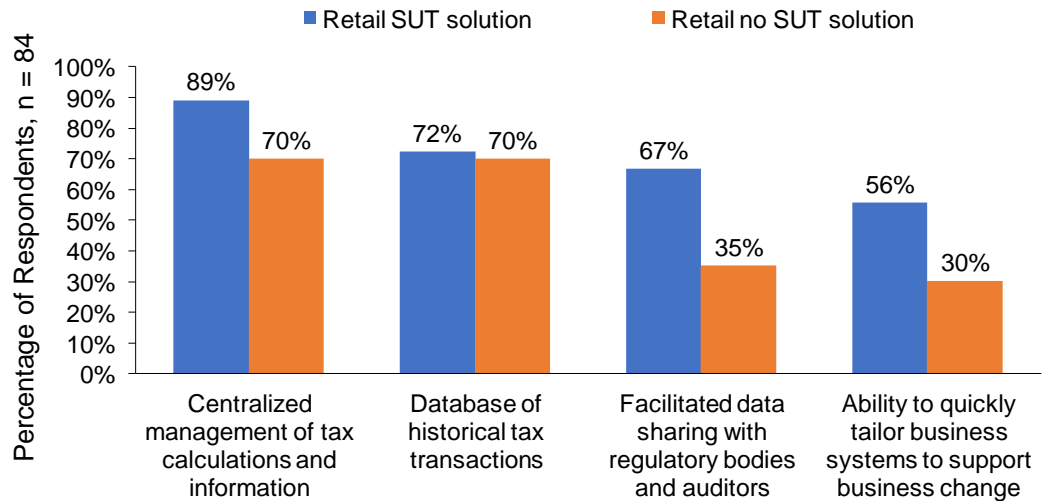Source: Aberdeen Group, April 2017

Automated research can then be applied to business systems to ensure that the process is completed accurately. In fact, retailers with SUT solutions are 57% more likely to have automated tax calculations for complex tax rates and rules (Figure 9). This means that when a sale happens, tax is automatically applied and collected at the correct rate across all transactional systems. Those with a full end-to-end solution are also 18% more likely to use their tax technology to process AP transactions. In many cases, Use Taxes — including internal purchases, promotional use of inventory, drop shipments, P-Cards, and other unique scenarios — can make the purchase side of the business one of the most problematic.

The next steps in the SUT compliance process are reporting, filing, and managing audits. Utilizing technology tools, retailers can ensure accuracy and efficiency in these processes. This is due to the

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fact that these organizations have centralized systems containing all of the information that is generated from tax workflows (Figure 10). This fits in very nicely with the centralization strategy being adopted by the majority of Leading retailers today. Further, those with solutions are 91% more likely to have facilitated data sharing with regulatory bodies and auditors. This reduces the impact of audits by ensuring all data is collected and reported correctly, and shared easily. This improves compliance while reducing the effort it takes and maintaining relations and will continue to grow as a standard expectation as regulators continue to ask for more data in real time.

Figure 9: Facilitating Filing and Reporting

■ Retail SUT solution ■ Retail no SUT solution

Percentage of Respondents, n = 84

- Centralized management of tax calculations and information: 89% / 70%
- Database of historical tax transactions: 72% / 70%
- Facilitated data sharing with regulatory bodies and auditors: 67% / 35%
- Ability to quickly tailor business systems to support business change: 56% / 30%

Source: Aberdeen Group, April 2017

Lastly, the SUT regulatory environment is always evolving; a foundation for compliance is never complete. As a result, another benefit for those with SUT solutions is that they are 87% more likely

to have the ability to quickly tailor their business systems to support rapid business change.

These organizations can implement continual improvements and more mature reporting tools to help manage the data for monthly reconciliations, audit defense, and management reporting. By relying on the experience and functionality provided by a SUT software vendor, retailers can ensure compliance at a lower cost for years to come.

The Results

Ultimately, the purpose of implementing a SUT solution is to improve compliance, which will have an impact on the bottom line due to the costs of labor and potential penalties. Fines can be substantial, so the uncertainty associated with noncompliance is something that business leaders just cannot live with.
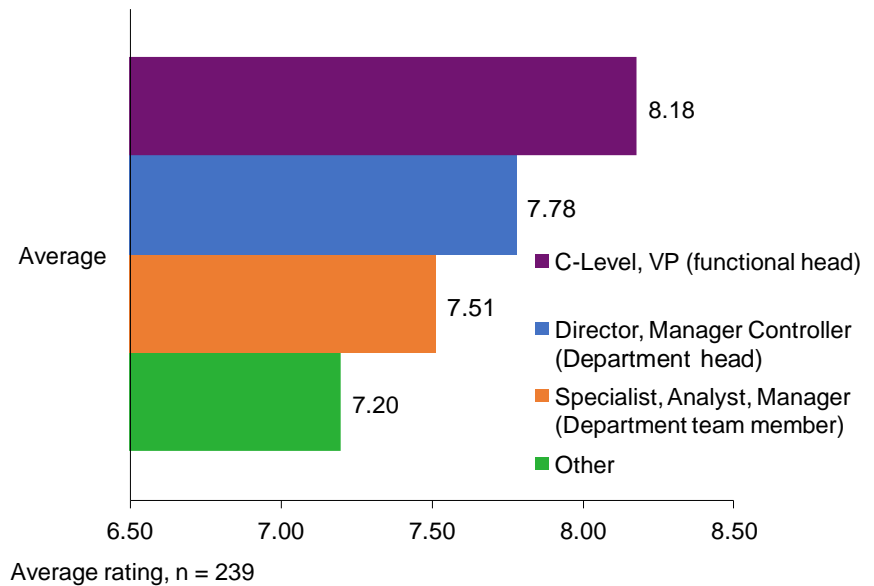
In fact, confidence in SUT compliance is crucial, because it is the heart of the argument for getting your organization to sign off on making many other improvements. Too many business leaders simply assume that their organization is compliant. This is evidenced by the varying ratings provided by different levels within an organization (Figure 11). Those that are closer to the day-to-day management of SUT are far less confident. These individuals best understand the inherent risk of having a high degree of confidence without the proper tools. Therefore, they must build a strong business case when asking those that hold the purse strings for the technology they desperately need to not only maintain compliance, but do it in the most cost-effective way possible.

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Through their SUT solutions, Leaders have lessened the impact of an increasingly complex SUT environment:

- **Days to complete an audit:**
  - Leaders — 6.2
  - Followers — 7.2
- **Average penalties paid when audited:**
  - Leaders — $25,313
  - Followers — $51,417
- **Increase in the amount of effort it takes to manage tax compliance over the past 2 years:**
  - Leaders — 6%
  - Followers — 8%
- **Increase in the cost of penalties over the past 2 years:**
  - Leaders — No change
  - Followers — 4%
- **Increase in the number of employees dedicated to compliance over the past 2 years:**
  - Leaders — 2%
  - Followers — 5%
- **Increase in risk of non-compliance the past 2 years:**
  - Leaders — 2%
  - Followers — 7%
- **Increase in the amount of time spent responding to audits over the past 2 years:**
  - Leaders — 4%
  - Followers — 8%

Figure 11: Business Leaders are Too Confident

Source: Aberdeen Group, April 2017

The best way to build a case for purchasing a SUT solution is to point to the need for a more strategic approach to compliance, given the rapidly changing nature of retail and regulatory environments. Tax compliance is getting more difficult, and therefore more expensive, as too many organizations are forced to add people and man-hours while continuing to struggle with outdated systems that can't keep up with the pace of change in the business.

However, those taking a more proactive approach with modern SUT solutions improved performance and saw a 50% smaller increase in the amount of effort it takes to maintain compliance over the past two years. This is because these organizations saw significant

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improvements in the amount of time spent on individual tax workflows such as filing, data reconciliation, and recovery (Table 3).

In fact, those with SUT solutions saw a 43% decrease in the amount of time it takes to complete an audit when compared to those without SUT solutions. Additionally, these retailers spend 40% less time on technology maintenance, which is a hidden cost of tax compliance. Apply these time savings to your current resources and the impact on the bottom line will be substantial and ongoing, as these gains in performance and efficiency will continue to be realized over time.

Table 3: Time Savings with a SUT Solution

Task	Reduction in Time
Days to prepare for and complete an audit	43%
Hours per employee dedicated to filing / remittance	26%
Hours per employee dedicated to reverse audits and recovery	2%
Hours per employee dedicated to technology / infrastructure updates / maintenance	20%
Hours per employee dedicated to managing / preparing for audits	48%

Source: Aberdeen Group, April 2017

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Key Takeaways and Recommendations

The SUT regulatory environment for today's retailers is increasingly complex, putting them at greater risk of non-compliance. Operating across multiple locations, online sales, and varied and changing mandates across jurisdictions is a recipe for disaster without the right tools to maintain compliance. Retailers are spending a significant amount of time and money attempting to keep up, and many are still ineffective. This *will* impact the bottom line. The average penalty due when audited is $$47,063, and retailers typically spend up to 1% of their revenue on penalties due to filing errors. In order to reduce the impact of SUT compliance on operations and avoid burdensome costs, heed these recommendations:

➔ **Centralize compliance.** For a geographically dispersed retail organization, **c**entralizing compliance allows your organization to do more with fewer employees. It can focus on one singular set of expertise rather than duplicating efforts across locations. It also ensures that data is managed and standards are met across all business systems and transaction types.

➔ **Invest in technology.** Through a SUT compliance solution, your organization can rely on the expertise and capabilities of the software vendor to automate processes and ensure consistency, greatly lessening the burden on compliance and IT teams.

➔ **Proactively facilitate change.** One of the hardest parts of managing compliance is understanding the impacts when the business or tax regulations change. This challenge is exponentially increased when operating across many jurisdictions. Research can be time-consuming and confusing. Using a SUT solution, your organization can have the confidence that your organization is always up to date with the latest rates and rules.

➔ **Automate workflows.** Top performers are more likely to utilize technology that automatically calculates SUT to ensure accuracy across all of their transactional systems. Workflows will be performed correctly and immediately.

➔ **Support filing.** SUT compliance solutions automate filings with accurate information. This helps identify and correct errors before filing, and reduces the time it takes to put them together. It also facilitates communication and improves relationships with regulators.

➔ **Be prepared for audits.** If your organization has a centralized database featuring all necessary information, these processes will go more smoothly and cost less.

A complete SUT solution provides retailers with the confidence that they are compliant, no matter where they operate.

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