SALES AND USE TAX COMPLIANCE FOR MANUFACTURERS: BOOST CONFIDENCE, ENSURE ACCURACY

Report Highlights

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The top challenge for manufacturers today is increased audit frequency and costs.

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77% of manufacturers centralize Sales and Use Tax compliance.

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Leaders are 22% more likely to have a complete Sales and Use Tax compliance solution.

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Manufacturers, with solutions, saw significant improvements in the time spent on individual tax workflows and the time it takes to complete an audit.

This report reveals the complex challenges that manufacturers face today, in indirect tax, and provides a roadmap for sidestepping the increases in difficulty that are coming in the near future.

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In a recent study, 50% of manufacturers stated that audit scrutiny and frequency has increased over the past two years. Even scarier, another 60% of manufacturers believe that audit frequency and scrutiny will continue to increase over the next three to five years.

The Sales and Use Tax (SUT) regulatory environment is increasingly complex and onerous for today's manufacturers. In a recent study, 50% of manufacturers stated that audit scrutiny and frequency has increased over the past two years. Even scarier, another 60% of manufacturers 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 manufacturers of all sizes due to their complexity, these trends can be particularly concerning for the mid-market. Manufacturers between $100 million and $1 billion in annual revenue, are 54% more likely to have seen an increase in audit scrutiny and frequency over the past two years. These manufacturers are at risk of being negatively impacted by SUT compliance in ways that can hinder their growth. These processes can be difficult to complete successfully, but the risks associated with non-compliance make them too important to ignore. Therefore, it behooves manufacturers (of all sizes) to avoid the challenges associated with SUT compliance by making changes to the way they approach SUT management. This report reveals the complex challenges that manufacturers face today, in indirect tax, and provides a roadmap for sidestepping the increases in difficulty that are coming in the near future.

The Manufacturing SUT Environment

The current regulatory environment is fraught with risk for today's manufacturers. Survey takers were asked to indicate the biggest risk to their organization that is posed by their current SUT process (see Figure 1, next page). Plainly put, there is a significant amount of risk associated with penalties from inaccurate, late, or incomplete filings. These penalties can be costly, which can hinder organizations of all sizes. Expenses can include the actual cost of fines, or the missed opportunity of the investments that could have been made if those fines had not been incurred. In fact, non-compliance brings opportunity costs in both the money and human resources that could be better spent elsewhere. Those

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In this survey, respondents fell into the following demographics:

- **Function:**
  - Tax: 41%
  - Finance: 31%
  - IT: 26%
  - Other: 2%
- **Title:**
  - Specialist, Analyst, Manager (Department team member): 37%
  - C-Level, VP (functional head): 32%
  - Director, Manager, Controller (Department head): 26%
  - Other: 5%
- **Revenue:**
  - More than $2 billion: 23%
  - $1 billon to $2 billion: 12%
  - $500 million to $1 billion: 12%
  - $100 million to $500 million: 27%
  - $50 million to $100 million: 14%
  - Under $50 million: 11%

manufacturers – that ignore SUT compliance improvements – are playing with fire when it comes to their bottom lines and reputations.

Figure 1: Biggest Risks in SUT Compliance
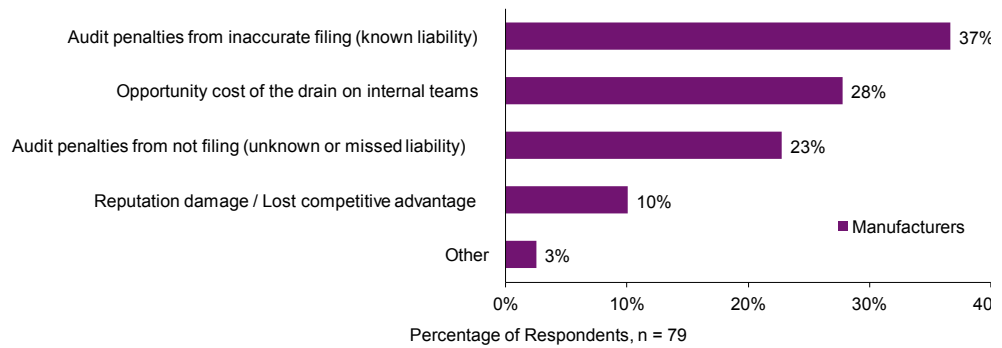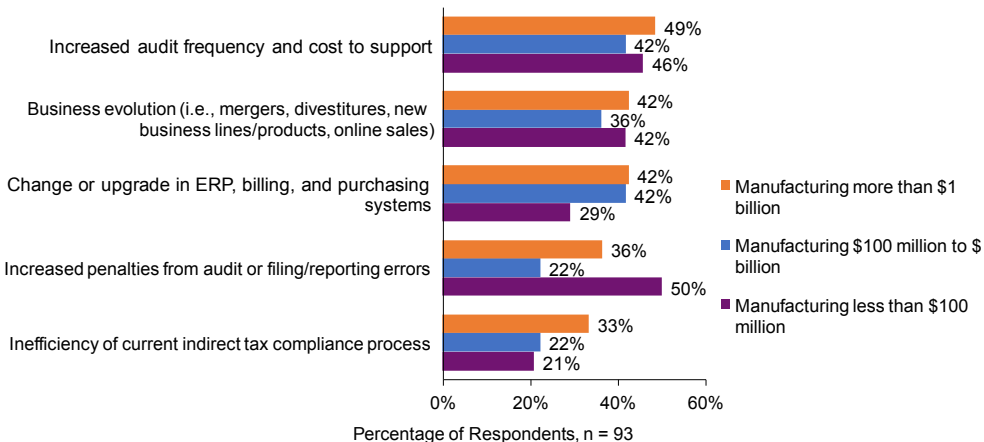

Source: Aberdeen Group, April 2017

Manufacturers 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 (Figure 2, next page). These challenges vary from the cost to support audits and the inefficiency of current processes, to changes in business models as a whole, such as the introduction of online sales. Larger manufacturers are challenged more by a changing environment, including business change, growth into new markets, changes in technology, and outside regulatory pressure.

Smaller manufacturers are just struggling to keep up. They have less mature systems, fewer internal resources, and are too focused on growth to take the time to understand their obligations.

Interestingly, 56% of all manufacturers state that they are either not filing in jurisdictions where they should be filing today, or they are unsure of the jurisdictions in which they are obligated to file. In these cases, what they don't know can hurt them.

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Figure 2: Top Challenges

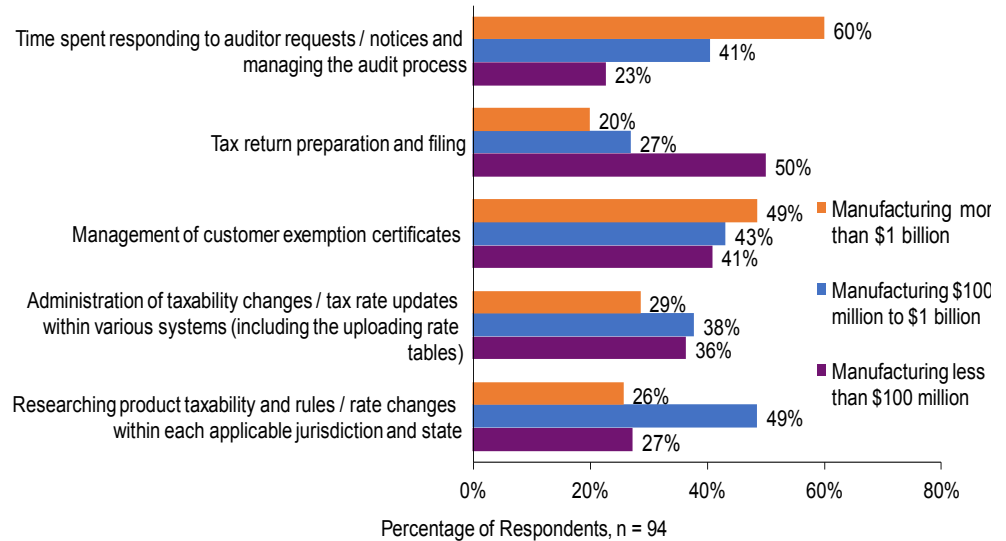| Challenge	Manufacturing more than $1 billion	Manufacturing $100 million to $ billion	Manufacturing less than $100 million
Increased audit frequency and cost to support	49%	42%	46%
Business evolution (i.e., mergers, divestitures, new business lines/products, online sales)	42%	36%	42%
Change or upgrade in ERP, billing, and purchasing systems	42%	42%	29%
Increased penalties from audit or filing/reporting errors	36%	22%	50%
Inefficiency of current indirect tax compliance process	33%	22%	21%

Percentage of Respondents, n = 93

Source: Aberdeen Group, April 2017

In fact, the challenges listed above put significant strain on today's manufacturers (Figure 3, next page). All sizes are impacted by performing tax-related workflows such as filing, managing exemption certificates, researching regulatory change, and administering changes in workflows and business systems. Much of this is confusing, takes a significant amount of time, and costs money. Of course, in a frequently changing regulatory environment, the work is never done.

Figure 3: Biggest Drains on the Business

Time spent responding to auditor requests / notices and managing the audit process
- 60% (Manufacturing more than $1 billion)
- 41% (Manufacturing $100 million to $1 billion)
- 23% (Manufacturing less than $100 million)

Tax return preparation and filing
- 20%
- 27%
- 50%

Management of customer exemption certificates
- 49%
- 43%
- 41%

Administration of taxability changes / tax rate updates within various systems (including the uploading rate tables)
- 29%
- 38%
- 36%

Researching product taxability and rules / rate changes within each applicable jurisdiction and state
- 26%
- 49%
- 27%

Legend:
- Manufacturing more than $1 billion
- Manufacturing $100 million to $1 billion
- Manufacturing less than $100 million

X-axis: 0% 20% 40% 60% 80%

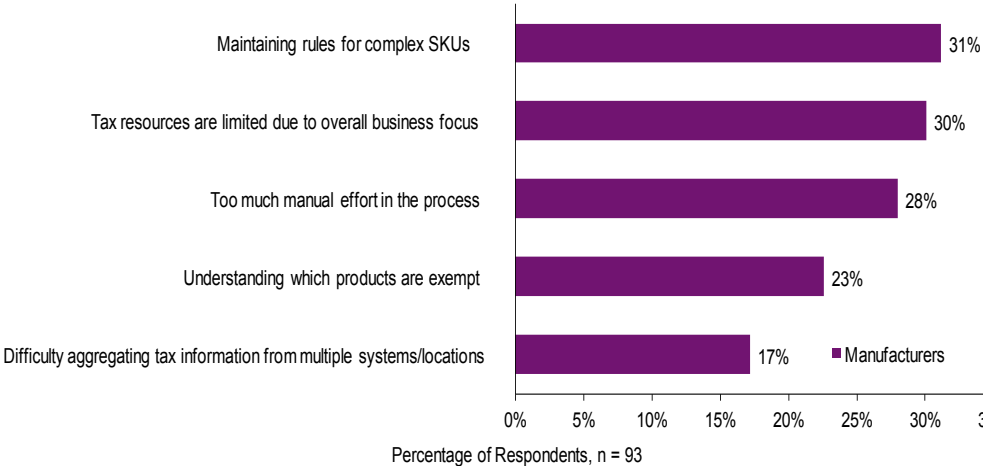Percentage of Respondents, n = 94

Source: Aberdeen Group, April 2017

Still, there are some differences – in the specific drains – that are more impactful, dependent on company size. Larger organizations are under much more scrutiny and are hindered in the audit process. Smaller manufacturers are just struggling to keep their processes up-to-date and complete them efficiently.

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 manufacturers specifically (Figure 4, page 6). These challenges can be related to managing high numbers of SKUs, as well as limits in access to resources, technology, and research. For today's manufacturer, superior performance in SUT management is far from assured.

Figure 4: Top Challenges for Manufacturers

Challenge	Percentage
Maintaining rules for complex SKUs	31%
Tax resources are limited due to overall business focus	30%
Too much manual effort in the process	28%
Understanding which products are exempt	23%
Difficulty aggregating tax information from multiple systems/locations	17%

■ Manufacturers

Percentage of Respondents, n = 93

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, page 7). Today, on average, manufacturers are spending a significant amount of time on audits, producing a large amount of returns that are inaccurate or late, and paying substantial fines.

Table 1: Performance

Metric	Performance
Number of audits over the past 5 years	> 30
Number of audits over the past 12 months	3.1
Days to prepare for and complete an audit	10.6
Average penalties paid when audited	$55,070
Percentage of revenue spent on penalties due to filing errors	2%
Returns that were 100% accurate over the past two years	60%
Filings that were late over the past two years	24%
Employees used to manage compliance	13.9

Source: Aberdeen Group, April 2017

Note how many employees are typically used to manage compliance. When you multiply that 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 (see Table 2, next page). 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.

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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

Table 2: Hours Per Employee, Per Month

Task	Hours
Researching tax rates	5
Management reporting / analysis	6.9
Filing / remittance	8.1
Reverse audits and recovery	6
Data reconciliation	7.4
Technology infrastructure updates / maintenance	4.6
Preparing / managing audits	8.7

Source: Aberdeen Group, April 2017

Truly, the SUT compliance environment for manufacturers brings many challenges that can put a strain on the business. To succeed, manufacturers must adjust their SUT strategies to become more effective, and minimize the cost of compliance.

Leading Strategies for SUT Compliance

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

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Figure 5: Top Strategies

Percentage of Respondents, n = 86
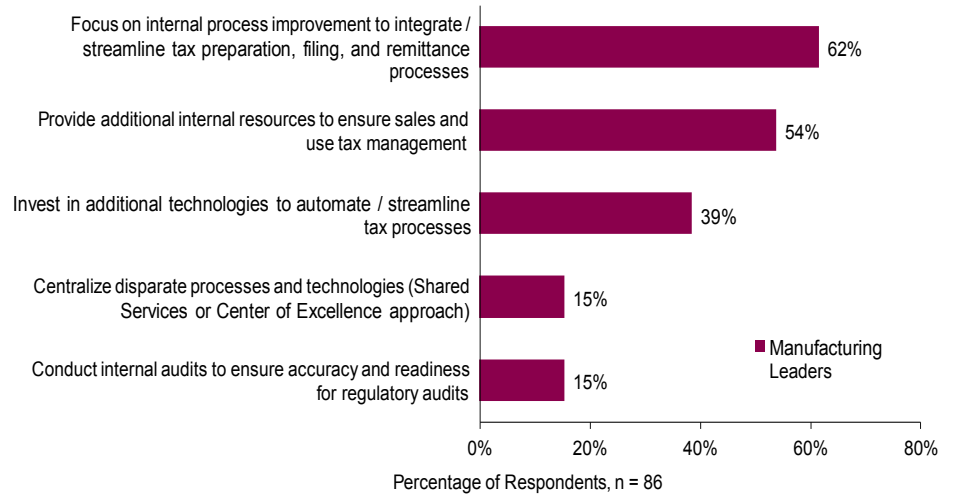
Source: Aberdeen Group, April 2017

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

- **Percentage of returns that were accurate over the past two years:**
  - Leaders – 94%
  - Followers – 80%
- **Percentage of filings that were late over the past two years:**
  - Leaders – 6%
  - Followers – 30%
- **Change in the amount of time spent managing compliance over the past two years:**
 - Leaders – 4% decrease
  - Followers – 13% 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 new resources and technology. Through technology, Leaders can automate processes, have access to current research, and ensure the accuracy of information. Ultimately, it's about confirming accuracy with as little impact to ongoing operations as possible. This is the primary goal when a manufacturer chooses to manage SUT in a shared services center.

In fact, 77% of Leading manufacturers manage SUT in one centralized location (Figure 6, next page). By centralizing, manufacturers can invest in one single set of resources, rather than having to duplicate them across many locations. The company can invest in one knowledge set and ensure that standards are followed. Of course, there are some challenges related to centralization. In a geographically dispersed organization, particularly as online sales increase, it is difficult to maintain knowledge of the particular requirements in individual jurisdictions.

Therefore, it becomes necessary to pair centralization with technology.

Figure 6: Centralizing Compliance

Percentage of Respondents, n = 86
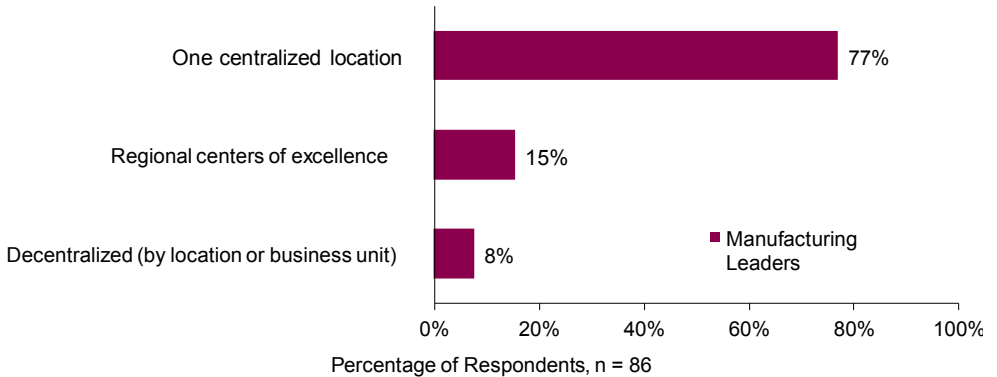
Source: Aberdeen Group, April 2017

As manufacturers attempt to centralize tax functions, there are a variety of technology mixes that they can attempt to implement (Figure 7, next page). The consistent component in the technology mixes, is that the majority of organizations ($100M and above) have adopted is a purpose-built tax solution. These solutions can be paired with ERP, and other technologies, to create a centralized system for tax compliance. Of course, the technology mixes do vary by the size of the manufacturer. Larger organizations are more likely to purchase a solution. The midmarket is a mix of build and buy, but is more likely to outsource or build their own.

Any organization that has attempted to build their own solution, understands the challenges that come along with that, including integration challenges, resource constraints, keeping up with rapid regulatory change, and other internal operational and maintenance costs. A purchased solution, ensures that your organization is able to take advantage of the tax expertise of the software vendor, reduces the need to use internal resources (particularly IT) to continuously build in changes to tax regulations, while also ensuring integration with existing ERP. Still, it is consistent that solutions need to be specifically built for tax compliance, given the

complexity of the rates and rules, transactional granularity now required by auditors, and the near real-time nature of many regulatory changes. Leaders have addressed this through the technology they have implemented, as illustrated below:

Figure 7: Technology Mix

Percentage of Respondents, n = 65
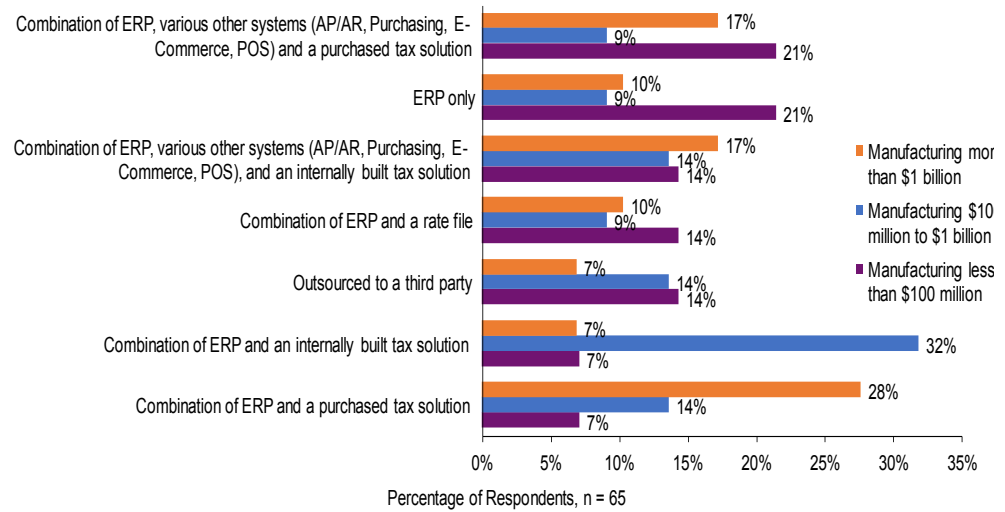
Source: Aberdeen Group, April 2017

Leaders are more likely to have implemented a wide variety of tools that assist in SUT compliance (Figure 8). 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 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. This creates a seamless process that is critical in preparing for and managing audits. By investing in one comprehensive package, tax professionals will get a solution that supports their needs from end-to-end, in a package that is easier to implement and is more cost-effective. There is a smaller impact on internal resources, helping to

keep the cost of compliance lower. They can rely on the software vendor to enforce changes to tax laws, and will receive 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 are unaware if there are jurisdictions that they should be filing in that they are not, those without solutions are more likely to be aware of their mistakes. Thirty-one percent (31%) of those with SUT solutions, state that they are aware of jurisdictions that they should be filing in that they are not. This is in comparison to 23% of those without solutions. Therefore, it shows that these solutions help manufacturers to better understand tax requirements and how to manage to them.
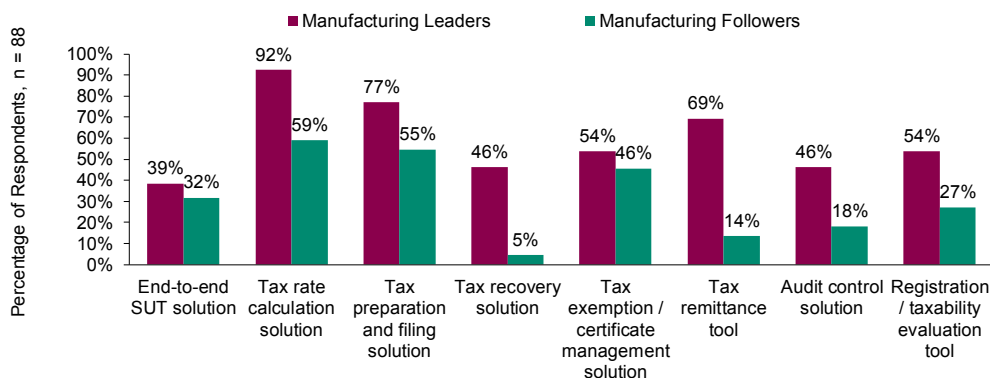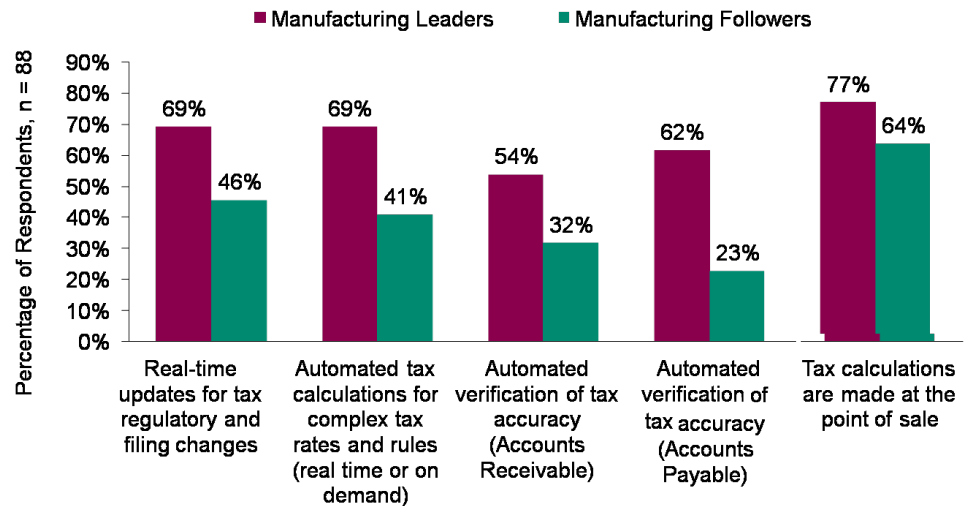

Source: Aberdeen Group, April 2017

Figure 8: Leaders Look to Complete Solutions

By relying on the capabilities of their software vendor, Leaders have implemented several SUT compliance capabilities. These capabilities ensure that compliance workflows are completed accurately and efficiently. First, Leaders rely on these solutions to make sure that they are acting in according with correct and up-to-date mandates across all of the jurisdictions they operate in.

Traditionally, research has been a time-consuming and confusing component of managing SUT compliance. Instead, Leaders are 50% more likely to have real-time updates for tax regulatory and filing changes. This is a life saver, because without this capability, the onus is on internal tax, finance, and IT teams to do the research, stay on top of changes, and administer timely updates across all of their transaction processing systems.

Figure 9: 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, Leaders are 68% more likely to have automated tax calculations for complex tax rates and rules. This means that when a sale happens, tax is automatically applied and collected at the correct rate.

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

adopted by most manufacturers today. Further, Leaders are twice as likely to have facilitated data sharing with regulatory bodies and auditors. Therefore, they can drastically reduce the amount of time spent on these tasks.

Figure 10: Facilitating Filing and Reporting

Source: Aberdeen Group, April 2017
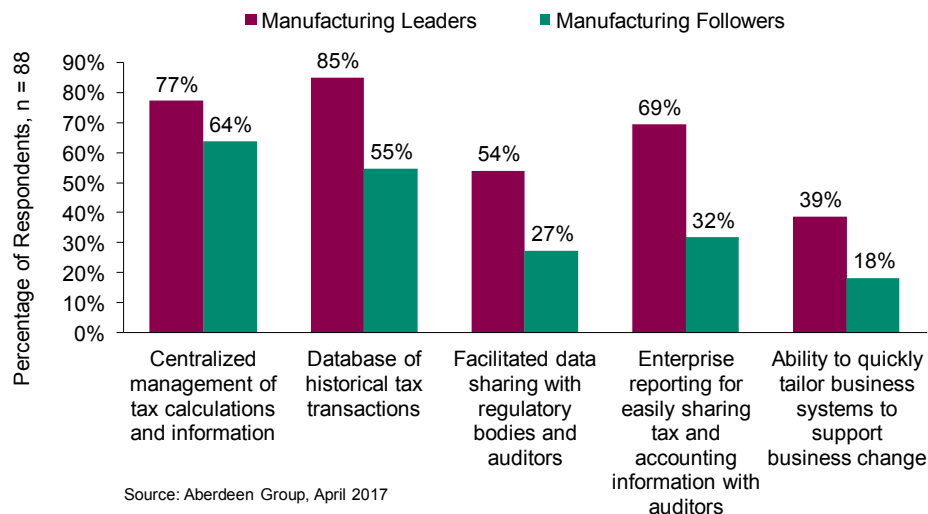
Lastly, the SUT regulatory environment is always evolving, so a manufacturer's job, in ensuring compliance, is never done. In fact, 61% of Leaders have established benchmarks that they monitor to understand how well their SUT processes are performing in comparison to 39% of Followers. Leaders take these insights and use them to quickly adapt, as they are over twice as likely to have the ability to quickly tailor their business systems to support rapid business change.

These Leaders 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, manufacturers 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.

SUT solutions help those responsible for the process to sleep better at night. In fact, when asked to rate how confident they are in their SUT compliance on a scale of one to ten, those with solutions rated themselves 16% higher (Figure 11, next page). Proof of that confidence comes in the fact that those with solutions are more likely to know when there are jurisdictions that they should be filing in (that they currently are not). These solutions help to provide awareness of gaps and enable manufacturers to make improvements when necessary. Otherwise they would be flying blind.

Figure 11: Compliance Confidence

Average rating, n = 89
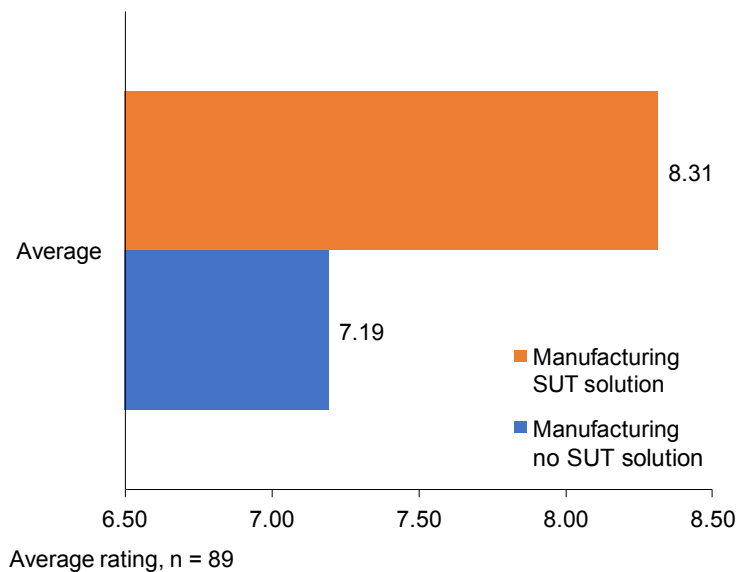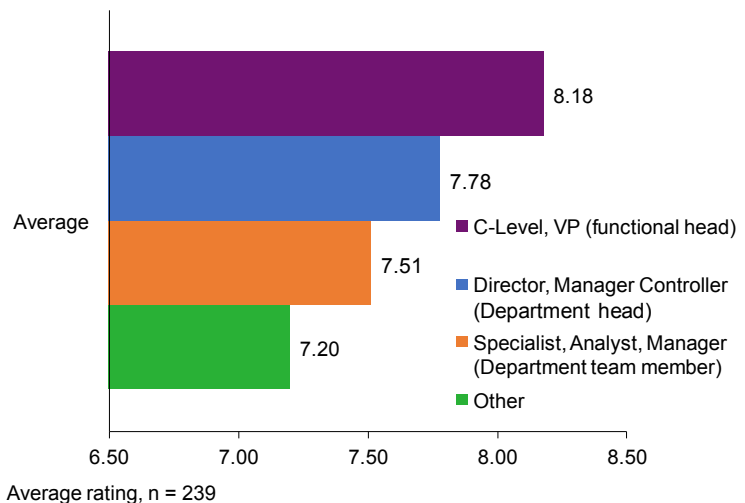
Source: Aberdeen Group, April 2017

Confidence in SUT compliance is important, because it is the heart of the argument in getting your organization to sign off on making improvements. Business leaders simply assume that their organization is compliant. This is evidenced by the varying ratings provided by different levels within an organization (Figure 12, next page). Those that are closer to the day-to-day management of SUT, are far less confident. These individuals best understand where the risk lies and the time, effort and risk involved with maintaining 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.

Figure 12: Business Leaders are Too Confident

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

- **Percentage of revenue spent on fines due to filing errors:**
    o Leaders – 1%
    o Followers – 2%
- **Average penalties paid when audited:**
    o Leaders – $8,733
    o Followers – $64,524
- **Change in the amount of effort it takes to manage tax compliance over the past two years:**
    o Leaders – 2%
    o Followers – 13%
- **Increase in the cost of penalties over the past two years:**
    o Leaders – 4%

Average

8.18
7.78
7.51
7.20

■ C-Level, VP (functional head)
■ Director, Manager Controller (Department head)
■ Specialist, Analyst, Manager (Department team member)
■ Other

6.50   7.00   7.50   8.00   8.50

Average rating, n = 239

Source: Aberdeen Group, April 2017

The best way to build a case for purchasing a SUT solution is to point to the bottom line. Tax compliance is getting more expensive, but those with SUT solutions saw a 30% smaller increase in the cost of compliance over the past two years. This is because these organizations 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. Additionally, these manufacturers spend 53% 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 is substantial. Of course, none of this is relevant if compliance is not achieved. Those with a SUT solution achieved greater accuracy and were 11% less likely to file late.

Table 3: Time Savings with a SUT Solution

Task	Reduction in Time
Days to prepare for and complete an audit	3%
Hours per employee dedicated to researching tax rates	16%
Hours per employee dedicated to filing / remittance	10%
Hours per employee dedicated to data reconciliation	13%
Hours per employee dedicated to technology / infrastructure updates / maintenance	53%

Source: Aberdeen Group, April 2017

Key Takeaways and Recommendations

Regardless of their size, today's manufacturers are significantly challenged in their quest for SUT compliance, as they continue to offer more SKUs and sell products across more jurisdictions. The risk of non-compliance is substantial, as the average penalty due when audited is $55,070, and manufacturers typically spend two percent of their revenue on penalties due to filing errors. This impacts the bottom line and can hold manufacturers back from

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focusing on their core business. In order to continue their growth, manufacturers must remove the hurdles from SUT compliance, minimizing the time spent on research and tax workflows, to keep costs low and maintain accuracy. In order to achieve SUT compliance, heed these recommendations:

➔ **Centralize compliance.** Centralizing 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 manufacturer 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.

➔ **Facilitate research.** One of the hardest parts of managing compliance is understanding when tax regulations change. This research can be time consuming. Using a SUT solution, your organization can have the confidence that your organization is always up-to-date with the latest regulatory analysis.

➔ **Automate workflows.** Top performers are more likely to utilize technology, that automatically calculates SUT, to ensure accuracy.

➔ **Support filing.** SUT compliance solutions automate filings with accurate information. This reduces the time it takes to put them together.

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

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Through a complete SUT solution, your manufacturing organization can be confident that compliance is achieved.

For more information on this or other research topics, please visit www.aberdeen.com.

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Quit Playing with Fire: Use Centralized AEOI Solutions to Prepare for FATCA, CRS, and CDOT; October 2016	*The Costs of Compliance: Strategies for Automating Tax Management in the Cloud and Avoiding Hidden Costs*; December 2014

Author: Nick Castellina, Vice President and Research Group Director, Business Planning and Execution

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