Conquering Manufacturing Tax Compliance Challenges

The battle starts with a strong tax data management foundation.

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Internal indirect tax groups across all industries leverage supporting automation to "address their greatest challenges, including talent shortages, compliance requirements, and regulatory complexity.[1] This is the case within manufacturing companies, where operations teams and back-office functions, including tax groups, have their eyes on investments in artificial intelligence (AI) tools, machine learning and other advanced technologies.

Yet, to fully harness the power and value of emerging technologies, indirect tax groups in manufacturing companies must strengthen foundational tax automation and tax data management capabilities that support compliance activities.

This is no small task in an industry brimming with complicated supply chains, intricate logistics and unique warehouse management approaches. Those factors pose unique and substantial compliance challenges, regardless of whether a manufacturer is subject to sales and use tax (SUT), value added tax (VAT), and/or another goods and services tax (GST).

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Conquering manufacturing tax compliance challenges with the aid of tax automation requires:

- A grasp of the unique indirect tax compliance challenges manufacturers face;
- An understanding of the differences between native ERP tax functionality and a standalone tax engine; and
- A carefully considered business case for tax automation investments.

Tax-Relevant Manufacturing Trends

Manufacturers routinely address a host of disruptive forces such as geopolitical unrest, severe cost pressures, supply chain disruptions, intense regulatory scrutiny, labor market challenges, technological disruptions, reshoring mandates, and changing customer expectations. Many of these variables, including those that follow, pose major challenges to indirect tax compliance:

- **Regulatory scrutiny:** Manufacturers face a "regulatory onslaught," according to the National Association of Manufacturers (NAM). NAM research shows that the average manufacturer pays $29,100 per employee per year due to "unbalanced, burdensome regulations" while the smallest manufacturing companies bear an even higher regulatory burden ($50,100 per employee annually).[2]

- **Indirect tax rates and rules volatility:** U.S. sales and use tax rate changes reached a 10-year high in 2023.[3] In the EU, manufacturers also must adapt to a major indirect tax compliance shift: while e-invoicing and real-time reporting feature as major components of the ViDA plan intra-EU transactions, individual Member States are moving ahead with their own domestic e-invoicing and real-time reporting rules.

- **Local rules and fees:** U.S. states and local taxing authorities are embracing new fees: retail delivery service fees, environmental fees and the like. In most organizations, indirect tax groups take on the burden of fee compliance. Some states have issued more than 40 different fees; finding details on these collection and remittance requirements can be time-consuming. Additionally, existing billing and ERP systems often must be reconfigured to produce a separate line item on invoices for fees.[4]

- **The embrace of e-commerce:** Wholesalers, manufacturers and distributors are rapidly implementing and advancing their online sales capabilities, including the use of online marketplaces, mobile commerce, electronic data interchanges (EDI) and more. These e-commerce activities open a whole new world of compliance obligations due to the increasing number of countries that collect consumption taxes on online B2C sales to their citizens and increasingly assign tax liability to marketplaces facilitating these sales.

Four Compliance Hurdles

Those trends pose specific indirect tax compliance capabilities, including:

1. **Keeping pace with changing rules, rates – and digital transformation:** Once a manufacturing company operates in more than a handful of taxing jurisdictions, manually updating indirect tax rules and rates quickly becomes a time-consuming, error-prone and risk-laden process. While indirect tax groups need advanced supporting automation just as much as other business groups, they often lag behind accounts payable (AP), accounts receivable (AR), procurement and other business groups in digital transformation progress.

2. **Tracking the physical flow of goods:** For VAT compliance purposes, it is crucial to identify and monitor the physical flow of goods. This requires up-to-date information regarding customer, vendor and warehouse locations, transport flows, and all of the contracts that designate the structure and processes governing how goods move throughout complex supply chains. Without convenient access to accurate and current data on the flow of goods, it can be difficult to correctly identify the taxable entity.

3. **Managing exemptions:** The laws governing manufacturing exemptions vary by state in the U.S. Exemption rules related to machinery, consumables, integrated systems and temporary storage are especially prone to variance.

4. **Data management:** Addressing the previous challenges while sustaining compliance requires a formidable tax data management capability. New and emerging e-invoicing and real-time reporting mandates require tax groups to maintain the highest level of data quality.

> "Tax compliance is all about data quality – this is especially the case when it comes to e-invoicing and real-time reporting mandates. As such, data quality and data management should be addressed throughout the tax engine implementation."
>
> Peter Boerhof,
> Senior Director VAT,
> Chief Tax Office, Vertex, Inc.

Tax Automation Decision Points

As indirect tax leaders consider automation investments that help them address those compliance hurdles, they can pinpoint features that matter most by asking questions such as:

1. What is the breadth and depth of the organization's indirect tax compliance requirements?
2. How much time and effort does our current compliance approach consume?
3. Do we file returns in an automated manner?
4. Do we maintain centralized control of our tax data?
5. To what degree is our reporting centralized?
6. How quickly and easily does our tax technology scale in response to business growth?
7. Do we have the capacity and structure to accurately and timely sustain tax content in our transactional, finance and billing systems?

Insights generated by answering those questions will shed light on a common tax technology decision: whether to use the ERP system's native tax functionality or opt for a stand-alone tax engine. When evaluating the former, pay close attention to the ERP system's ability to handle complex scenarios, quickly update tax content (e.g., rules and rates), prepare and submit filings, and scale in response to business changes.

Similar criteria should be assessed when evaluating a tax engine. The most effective tax engines provide frequent and automated tax content updates, centralized control and reporting, automated filings, convenient scalability and a range of optional functionalities, including exemption certificate management and tax data analytics.

> "It's extremely valuable to have a centralized location to calculate all of your indirect tax: you're not piecing data together, and your rates and tax treatments are consistent."
>
> **Nick Skarlatos**, Tax Managing Director, Indirect Tax Automation National Practice Leader, BDO

Leading Questions about Implementation Practices

Teaming with experienced firms on tax engine implementation helps organizations increase ROI while leveraging leading practices. Addressing the following questions helps manufacturers and their external experts drive tax engine implementation success:

- How is stakeholder buy-in being secured?
- What is the process for selecting a tax engine that addresses all manufacturing tax compliance needs?
- How is data accuracy and data quality addressed in the implementation plan?
- Does the implementation adhere to a rigorous project methodology, one that defines all phases, milestones, quality checkpoints, roles, and dependencies?
- Are project team members dedicated to the implementation for the project's duration?
- Does the project team include professionals from the tax group, IT and other relevant business groups?
- What is the change management plan and how will it be performed?
- Have all requirements been identified and included in the project plan?
- Does the project plan examine every tax compliance (and tax-relevant) process, both upstream and downstream, and translate those activities into implementation and configuration requirements?
- What steps help facilitate the transfer of knowledge?
- How will user training, awareness training and maintenance training be delivered?
- What is the plan for continuous improvement following the implementation?

A Charter for Better Business Cases

When designing a business case, context matters: which costs and benefits are measured (and how they are measured) can have just as much impact on the investment decision as the actual cost-saving estimates.

Calculations are, of course, important and necessary. Effective business cases typically include quantifications of

- Tax compliance costs
- Tax compliance risks
- Tax technology maintenance costs
- Manual workarounds and other hidden costs associated with relying on an ERP system's native tax functionality
- Compliance-related investments in outside services vendors
- Costs associated with a new tax automation investment
- Costs of content maintenance

That said, tax leaders whose tax automation investments are approved often view the business case as an opportunity to underscore far-reaching impacts of indirect tax compliance to their CFOs and CIOs. Before finalizing calculations of costs and benefits, ensure that the business case addresses the following areas:

- **Customer satisfaction:** An efficient, highly automated order-to-cash cycle reduces customer billing questions (including those related to tax calculations and estimates), lowers day sales outstanding (DSO), enhances the customer experience, improves cash flow, and helps increase customer lifetime value. Tax compliance has an impact on customer satisfaction – and a strong business case establishes this link.
- **Vendor relationships:** Tax compliance accuracy improvements reduce the frequency of disputes with vendors while enhancing the efficiency of AP processes. Both outcomes have positive impacts on vendor relationships.
- **Tax-relevant business processes:** Besides the order-to-cash cycle, indirect tax processes affect risk management, procurement, accounts payable, revenue assurance and customer experience management. The role indirect tax compliance plays in supporting these and other processes should be identified in the business case.
- **The value of a "charter:"** A *business case* quantifies a potential investment's costs and benefits. A *charter* defines an institution's – or, in this case, a business group's – formal purpose and objectives. A business case supported by a tax department charter reminds CFOs, CIOs and other business leaders of the indirect tax group's mission – and how its objectives support and drive the achievement of corporate goals. When finance and IT leaders view the tax automation business case in the context of the company's strategic objectives, they are more likely to approve the investment.

"When it comes to the implementation, thorough planning is everything. We follow a rigorous project methodology that lays out all the phases, dependencies, milestones, quality checkpoints, and anything else that needs to occur. This way, we always have control over where we are in the process."

Kerstin Janz, Tax Managing Director - Indirect Tax Automation National Practice, BDO

Conclusion: Begin Now

A final suggestion: get started on the business case for tax automation today, regardless of your investment needs or plans. By creating an indirect tax group charter and quantifying known and hidden compliance costs, tax leaders can establish a convincing argument while leveraging those calculations to enhance their compliance performance metrics.

Keep in mind that questions about the efficacy of tax compliance capabilities and supporting technology can arise outside of tax. Boards, CEOs and CFOs track the same industry news and analysis as tax executives. "Many manufacturers are not fully realizing tax opportunities that could support their growth…" according to BDO research from earlier this year. "By increasing collaboration between tax and business leaders, manufacturers can more easily uncover tax planning opportunities to help improve their total tax posture."[5]

The most effective tax-business collaborations arise from a foundation of tax compliance; and a standalone tax engine serves as a foundational building block.

End Notes

[1] https://insights.bdo.com/2024-Tax-Strategist-Survey.html.

[2] https://nam.org/issues/regulatory-and-legal-reform/cost-of-regulations/.

[3] https://www.vertexinc.com/resources/resource-library/vertex-inc-2023-end-year-sales-tax-rates-and-rules-report.

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

[5] https://www.bdo.com/insights/industries/manufacturing/top-three-manufacturing-trends-for-2024.

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