Competitive Advantages of Sales Tax Automation

How industry leaders are using tax automation technology to optimize their business

Automation technology dates back as far as 270 BC. In the early days, it was relegated to a small group of early adopters for specialized uses, mostly in manufacturing. Today, it's main stream; a recent McKinsey study of 2,000 different work activities found that almost half (45%) could be automated with currently available technology.

While most companies agree that automation is a great time saver, truly great ones also view it as a way to gain advantage of their competition and drive growth.

An Accenture 2016 Technology Vision report found that 8 in 10 business executives see automation as a strategic tool. Its uses today are vast and varied, from the practical to the specialized: order management and fulfillment, human resources, sales and marketing, customer care, payroll, expense reporting and benefits management and transactional tax calculation and returns filing, among others.

Why great companies automate sales tax

Of all the tedious-yet-necessary activities that companies undertake in running a business, tax compliance likely tops of the list. Calculating, filing, and reporting required for sales and use tax compliance is not only time-consuming, it's also costly and highly prone to error—a terrible trifecta that make CFOs and controllers cringe. The average cost of managing transactional tax compliance is more than $60,000 annually for small businesses and nearly $400,000 for large organizations.[1]

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Automation is the number one strategy employed by leading companies compared with their trailing peers. Aberdeen Research found that these market leaders are three times more likely to automate sales tax. Yet only half of Fortune 1000 companies have an automated tax solution.

Lisa Serwin, CFO of VentureBeat, explains this gap. "In the very early stages, companies often have an outsourced bookkeeping function. It's not until later in their growth that they get an internal finance department, let alone a full time CFO. Tax is often an afterthought."

But it shouldn't be, says Serwin. "Using tax automation to ensure compliance is one of the best things you can do for your company. If there is an audit or a financing event, exit or IPO, being clean and consistent and having an auditable record is of the utmost importance."

Most promising technology companies get funding from venture capital or IPOs. Both events drive the need for better due diligence and tax management. Growth through mergers and acquisitions is common in the manufacturing and business services industry. As such, they need to be as rigorous as their high-tech and consumer brand counterparts in their tax compliance practices.

[1] *Aberdeen Research, The Costs of Compliance: Strategies for Automating Tax Management in the Cloud and Avoiding Hidden Costs*

As evidenced by Synergy Services. An audit revealed that the IT support and services company had miscalculated sales tax on more than $2 million in revenue. At the time, the company was operating in eight states and its salesforce was manually calculating tax rates for customer invoices.

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Synergy implemented Avalara's AvaTax sales tax automation software. The next year's audit showed zero miscalculations or errors. And every audit since has been clean. "We didn't have tax issues anymore. It's as simple as that," states Ben Moyer, CEO and owner. MyTech Partners acquired Synergy Services in 2013.

A best practice in scale and efficiency

Automating sales and use tax is a huge time and money saver for businesses. Forrester Research ran an economic impact study on several ERP customers and found that these companies had the equivalent of two accountants spending 70% of their time manually invoicing customers and determining sales taxes. After automating this process, these same companies saved the equivalent of 1.4 accountants' time and expense annually (an average of roughly $385,000 over five years).

TechValidate surveyed companies that use Avalara's sales tax automation software and found that, on average, these companies reduced the time spent managing sales and use tax by 50% or more. Some AvaTax customers saw even higher results–cutting their time from 20+ hours to less than one hour.

"When we started doing more business in different states, sales tax was getting more complex and taking more time for the team to manage...filing on time, getting the rates right, there was always a problem," says Ray Duong, Finance Analyst for Argus Software. "We looked at different sales tax solutions and Avalara was the front runner. It's already integrated with our system, it's automated, and it's simple to use. We went live within a week. It used to take hours to do sales tax. Now it's maybe an hour."

And it's not just finance that benefits. IT teams can focus on higher priority projects because they aren't saddled with complex integrations, time-consuming deployments and ongoing updates and uploads of new tax rates and rules. Customer service and loyalty gains from ensuring buyers have a better experience at checkout.

"Customers don't like it when one sales tax amount is shown when they place the order and a different one is charged when you ship the item," says Scott Cohn, VP of ecommerce for Chinese Laundry, a manufacturer and retailer of women's footwear. "A best practice, early in the checkout process, is to allow the customer to enter an address or postal code to calculate tax. Be very up front, because those pennies do make a difference," cautions Cohn. "If they have to call and talk to you, those four or five pennies could end up costing you dollars."

Growth without the pain

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As businesses grow, they are more likely to operate across state lines, which can trigger nexus – a "physical presence" in a state that creates an obligation to collect and remit sales tax. More states are expanding the definition of nexus to include activities such as employing remote staff, attending tradeshows, warehousing inventory or using drop shippers or third-party fulfillment. This means more companies are finding they now have nexus in multiple states. And this can push them beyond the threshold of managing sales tax manually.

"Up until a year and a half ago, we just had nexus in two states. Now, we have nexus in almost all 50 states," says Anne Marie Haus, finance director at Sharps Compliance, a provider of medical waste disposal services. "We just don't have the manpower or the expertise to understand how those changes affect us," adds Haus. "AvaTax automatically calculates the tax so we don't have to keep track of all the different tax rates or changes in the tax codes. It also saves us a lot of extra work at the end of every month to file all of our returns. I don't think we could have handled it without Avalara."

Automation as a way to adapt to change

Great companies also automate sales and use tax to avoid being out of compliance as their business grows and changes. Tax rates and rules vary widely from state to state and taxability rules and regulations change frequently. For some industries, like software and technology, with its quickly evolving delivery models, the rules are yet to be defined, making getting it right nearly impossible.

For other industries, the rules have always been complex. For example, in manufacturing, sales of raw materials are generally exempt. In some states, the machinery and equipment used in the manufacturing process are also exempt. However, the services related to installing and fixing commercial equipment may be taxable. Selling versus renting equipment has different tax implications as well.

Manufacturers are also starting to sell direct to distributors and end-users, often through an ecommerce site. This means they have to start collecting and remitting sales tax on those transactions and familiarize themselves with retail tax regulations.

While notably early adopters of automation, manufacturers typically had to custom-fit their ERP modules to their unique business needs. That usually didn't include sales tax automation. Software solutions like Avalara AvaTax integrated into ERPs have improved that functionality.

"We ran into issues updating our tax tables on our server. That was not a situation we wanted to continue," says Keith Hill, controller for Nora Systems, a commercial flooring manufacturer. "With Avalara's cloud-based technology, we have an immediate tax database available to us, up-to-date exemption certificate information, and can file returns cleanly at a minimal cost. We're spending less to get a much improved technology."

Construction is another area where tax treatments vary. In some states, construction is treated similarly to manufacturing when it comes to sales tax. In other states, construction is taxed more in line with services.

Business Services companies, previously outside the purview of sales tax, now have obligations to collect and remit sales tax in several states. And that number is growing as more states consider extending sales tax to services in addition to goods.

With sales tax automation, all these industry-specific and nuanced tax decisions are made for you. Avalara's tax engine applies the right tax rates, rules or exemption to every taxable transaction for 12,000 U.S. tax jurisdictions.

Solving the problem of 'sometimes taxable'

Most tangible products are subject to sales tax in the U.S. But there is a paradoxical category for certain goods and services that can be thought of as "sometimes taxable." Sellers of apparel, electronics, sporting goods, and shoes commonly come up against this issue during sales tax holidays, when those items are exempted, either fully or partially. Different states tax these categories in different ways. So while a company might think it is set with its tax compliance in one state or a set of states, selling in new states or introducing nexus may disrupt current practices. This can be a never-ending headache for many businesses, especially retailers and ecommerce companies that sell certain categories of products where use makes a difference in how the item is taxed.

That's something that Chinese Laundry faces with their products, says Cohn. "Certain states view functional products to be taxed differently than fashion products. So a belt may be considered to be functional whereas another article of clothing is not. I sell all different types of boots. Some, like rain boots, could be considered functional, while others are purely fashion," he explains.

"Trying to figure out how all of that breaks down is cumbersome." That's one of the reasons Chinese Laundry outsources sales tax to Avalara. "They help us figure out how each state charges tax on those various subsets of the products we sell."

The issue isn't specific to apparel. Take medical devices for example. A mouth guard designed to be used in sports may be taxed, while a mouth guard used at night as a medical or dental treatment may be exempt. Sellers of books, music and video often find themselves in a sometime taxable quandary around delivery of the product since tax rules can be different for tangible products (CDs, DVDs, books) versus digital downloads.

Sometimes taxable isn't restricted to product taxability. Many of the products and services involved in construction fall into this category. Companies that provide repair or installation services are also subjected to sometimes taxable regulations.

Avalara found that companies impacted by the sometimes taxable rule more readily accept the need for sales tax automation given the complexity of their tax requirements and the high margin for error. These companies make up 24% of Avalara's customer base.

Software may have it the hardest

Software and technology companies have unique challenges when it comes to managing sales tax. The taxability definitions and rules for software vary widely across jurisdictions and delivery mechanism. Today, software is taxed 450 different ways across 45 categories. For example, in some states, sales tax applies to the gross receipts from the sale of all service or maintenance contracts covering computer software. When computer software and nontaxable products (i.e. support services) are bundled together and not itemized on invoices, the entire amount may be subject to tax. Software support services and web site development services are often taxed differently.

The prevalence of subscription billing and SaaS delivery models also create a perfect storm. Selling via subscription service is great for generating recurring revenue, but by definition creates a new invoice, and therefore opportunity for errors on the books. And the borderless nature of SaaS delivery creates a tangle of taxability depending on sourcing rules in the jurisdictions of both the software vendor and the customer.

Not surprisingly, finance leaders at software and technology companies have been quick to adopt tax automation. They're comfortable with the cloud, see the benefits of technology over manual processes, and have high standards for scalability and performance in the solutions they use since these are often the same principles upon which their products are based.

"We run on a cloud-based environment and so do the users of our products," says Charles Best, CFO of BlackLine Systems, a financial process and controls SaaS company. "We're growing rapidly and need more robust sales and use tax capabilities. Avalara has perfected this niche and they've done it very well. There's no reason to do it in any other application."

Get on board with better compliance outcomes

The payoff of sales tax automation are compelling. Research shows that Avalara AvaTax customers:

- Cut their monthly returns prep and filing work in half
- Avoid overpayment 90% more often
- Pass audits without penalty 50% more often

So it's not surprising that once businesses decide to automate tax compliance, they never look back. More than 98% of the companies that implement Avalara's software are still customers Avalara customers today. That's more than 20,000 companies on 500+ technology platforms using Avalara solutions to instantly and accurately calculate sales tax and apply rates and rules for 12,000 taxing jurisdictions to 4 billion transactions annually.

If you aren't automating sales tax with Avalara, the question now is: what can we do to change that?

About Avalara

A privately held company, Avalara was founded by a team of tax and software industry veterans to fulfill a vision of delivering an affordable, scalable sales tax solution. Thus making what was not economically feasible in the past for mid-sized business not only affordable, but more accurate as well – all with the latest and most innovative technology available. From Bainbridge Island, close to Seattle, Avalara's knowledgeable staff works tirelessly to help customers put the hassles of sales tax compliance out of mind. Avalara's mission is to transform the tax process for customers by creating cost-effective state-of-the-art solutions. The company does so through integrated on-demand, Web-based software services that provide transparent transactions, accurate tax compliance, painless administration and effortless reporting.