THE CFO'S TAX COMPLIANCE RISK MANAGEMENT PLAYBOOK

Strategies for managing mergers and acquisitions, audits, and new financing transactions

GUIDE

Avalara
Tax compliance done right

Contents

The CFO's evolving role and impact on operational risk

To say the proverbial "buck" stops with the Chief Financial Officer (CFO) is an understatement. CFOs have one of the most challenging roles on the leadership team.

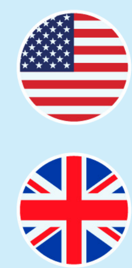
The CFO's job has developed beyond financial duties to become a strategic advisor to the Chief Executive Officer (CEO) and board of directors. CFOs must keep the business on budget, identifying where to cut expenses and where to invest to drive growth. They're also responsible for ensuring the business stays compliant, manages taxes properly, and adheres to a multitude of regulations.

Leaders are stretched thin. **Research commissioned by Avalara** found that 84% of CFOs surveyed in the United States and the United Kingdom face a significant staff shortage within their accounting and finance teams, and employee burnout is a concern.

The busy, fast-paced nature of the job can put a CFO and their company at risk. Avalara put this playbook together to help CFOs reduce and manage risk when it comes to tax compliance so they can focus on the big things. We've included tips to guide you through mergers and acquisitions, improve the likelihood of obtaining new financing, and survive a tax audit.

ACCOUNTING AND FINANCE TEAMS

84%



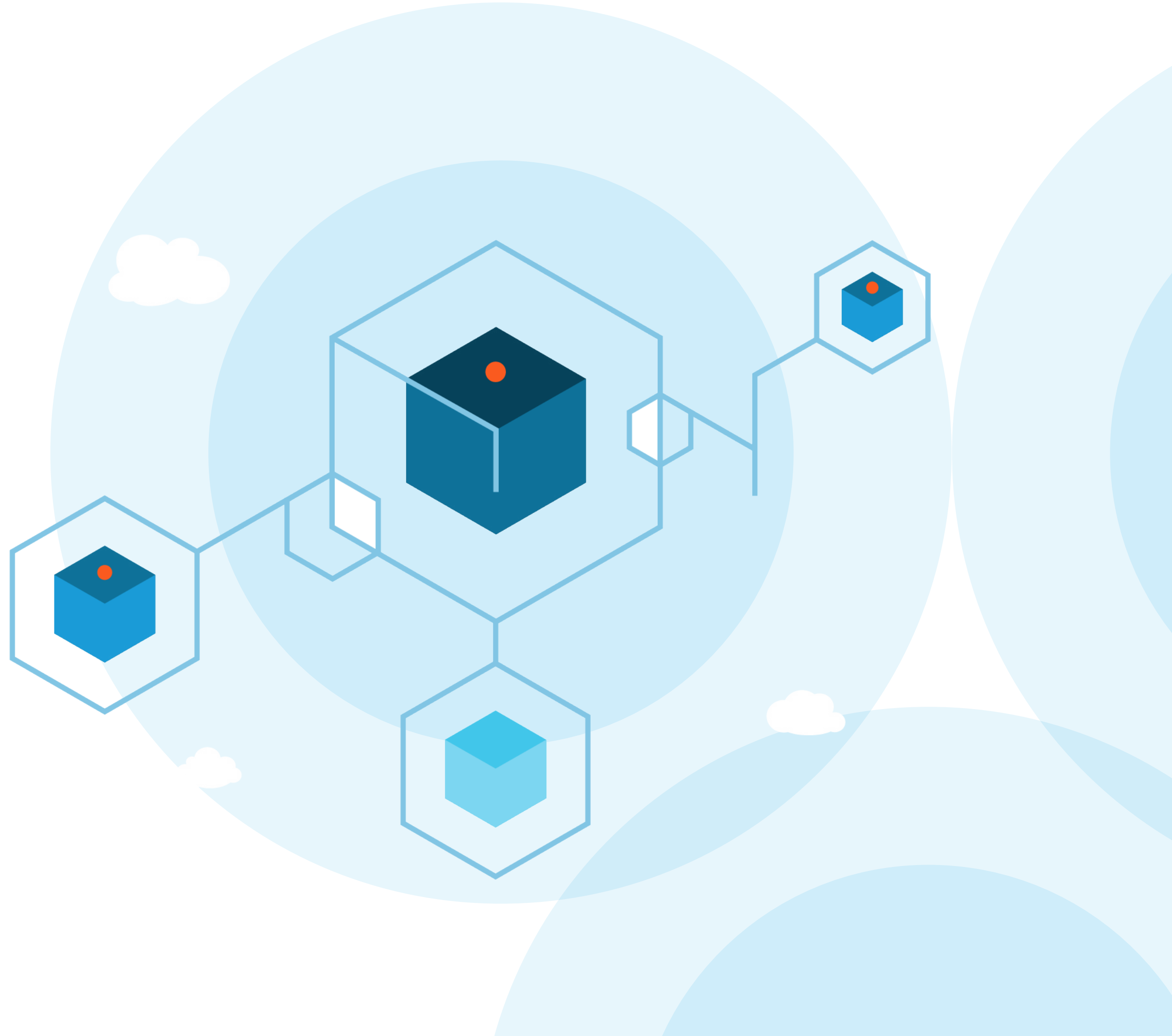
of CFOs surveyed in the United States and the United Kingdom face a significant talent shortage within their accounting and finance teams, and employee burnout is a concern.

SOURCE: *Research commissioned by Avalara*

Tax compliance risks associated with mergers and acquisitions

Mergers and acquisitions (M&A) are an exciting time for businesses. Two companies coming together can increase their market share, diversify their portfolio of products and services, and reduce competition. In 2023, the value of global M&A deals dropped to **$3.2 trillion**, the lowest level in a decade. **Deloitte analysis** predicts dealmaking may rebound in 2024.

However, M&A can also increase risk associated with tax compliance. CFOs need to know what to watch out for so they can uncover any concerns during the due diligence phase. Following are some of the common pitfalls that can come from mergers and acquisitions. Later, we'll describe how to address them.



HISTORICAL TAX NONCOMPLIANCE

If either or both companies overlooked tax obligations in the past, it could put the deal in jeopardy. For example, a business with a focus on rapid growth may unknowingly establish nexus in new states then fail to collect and remit tax in those jurisdictions. Post-acquisition, the parent company can inherit a substantial tax liability and be on the hook for unpaid taxes, interest, and penalties.

UNDERESTIMATED INDIRECT TAXES

Jurisdictions have different taxability rules and rates, which frequently change. In 2023, there were **85,836 taxability updates** in the U.S. and Canada alone. It can be difficult for businesses to keep up with sales and use tax, VAT, and GST requirements in locations where they currently sell.

Mergers and acquisitions make this even more challenging because your company can suddenly have obligations in many new states or countries. If you're not tracking tax changes closely, you could inadvertently undercharge tax. Consider, for instance, an electronics company that acquires a software firm, not realizing that **certain jurisdictions tax digital products** while others don't.

GLOBAL TAX OBLIGATION OVERSIGHTS

When M&A involves companies that sell globally, tax compliance obligations become more complex. In 2023, there were 337 international rate updates and 6,779 international taxability updates. Failing to calculate and remit VAT and GST correctly, assigning the wrong harmonized system (HS) codes, or incorrectly estimating customs and duties upfront can lead to unhappy customers and penalties.

EXEMPTION CERTIFICATE MISMANAGEMENT

Companies involved in mergers and acquisitions may provide products or services that are exempt from tax and/or sell to tax-exempt customers. Problems can occur if the businesses have different ways of tracking exemption statuses, and overlooking exemptions can lead to noncompliance. For example, a manufacturer that merges with a distributor could erroneously charge tax to resellers that purchase its products wholesale.

BUSINESS LICENSING GAPS

Without the proper business licenses and permits, your company might not legally operate following a merger or acquisition. Even if both businesses had all the necessary licenses and permits before they came together, those licenses may not be in good standing once the deal becomes final.

The consequences can be serious. If a large retailer were to acquire a smaller store chain and fail to obtain new licenses or update existing ones for some shop locations, that can lead to business disruption and fines.

A survey of risk, compliance, and accounting and audit professionals conducted by **Compliance Week and Avalara** revealed that businesses are aware of licensing complications during M&A but there's room for improvement in compliance management.

PROPERTY TAX DISCREPANCIES

When you acquire another business, your company is accountable for paying property tax for the target company's real estate and tangible personal property assets. There are 37 states that tax personal property, but not all personal property is taxable.

Complications can occur if the acquired company hasn't kept adequate records or failed to report certain assets altogether.

How assessors value your assets post-merger may be different from the fair value in your books, which could increase your assessment. In some cases, your only option is to file an appeal to avoid paying more tax than you should.

ERP INTEGRATION ISSUES

Two companies coming together need to consider whether their tech stacks can be integrated. It's highly likely the businesses use different ERP systems, or at least different configurations of the same system, to manage tax compliance. Post-merger integration can lead to data mismatches and problems like conflicting product catalog classifications and overcharging or undercharging tax.

OTHER TAX COMPLIANCE RISKS DURING M&A

While we've described several common tax compliance challenges that can accompany M&A, businesses may have other risks. Inconsistent tax strategies, failing to accurately account for deferred tax assets and liabilities, and overlooking tax-related clauses in contracts are some more factors that can lead to compliance concerns. Our **mergers and acquisitions guide** outlines common situations that may impact tax compliance and additional considerations to help you prepare.

The CFO's compliance risk management checklist for M&A

Refer to this handy checklist as you develop your strategy during a merger or acquisition. Taking these steps early in the M&A process can help your business address tax compliance considerations before they become a problem.

- ☐ Ensure both companies have accurately filed and paid sales and use taxes in all states where they have nexus. Investigate whether the target company has any outstanding liabilities that will continue to be a liability post-acquisition. Automate filing and remittance with a solution like **Avalara Returns** to stay compliant following a merger or acquisition.

- ☐ Stay on top of changing rates and regulations to prevent underpaying or overpaying sales and use tax and other tax types. **Avalara AvaTax** tracks taxability for products and services in all states and reduces the risk of noncompliance through regularly updated tax information.

- ☐ Assess compliance with VAT and GST regulations if either business operates internationally. Ensure registrations, filings, and payments are current in every country where the entity or entities sell. Consider a solution like **Avalara Cross-Border** to meet compliance obligations post-merger.

- ☐ Review each business's procedures for documenting and validating tax-exempt sales. Check that products and customers correctly qualify for exemptions, exemption certificates are up to date, and records as organized and easy to search during an audit. **Avalara Exemption Certificate Management** makes compliance easier.

- ☐ Inventory all business licenses held by both companies and make sure they are valid. Determine whether the acquiring company or merged entity needs to apply for new licenses or transfer existing licenses, and if any licenses will become redundant. Understand application requirements, which can include a waiting period or inspection. **Avalara Business Licenses** specialists are experienced in M&A consulting.

- ☐ Examine the target company's property valuations and related tax payments for potential undervaluation or unpaid taxes.

- ☐ Determine how ERP systems will be integrated. Create a plan for tax and financial data migration, and prepare to address any challenges in data consolidation in advance.

Considerations when seeking new financing

Seeking new financing for your business goes beyond making sure the balance sheet looks good. Lenders dive deep into the nitty-gritty details, including tax compliance. It's less risky to lend to businesses that demonstrate they're organized, reliable, and have a firm handle on their tax responsibilities.

Your ability to show lenders that you understand how to meet your company's tax obligations puts you one step closer to securing financing. Let's get into what lenders look for, aspects of tax compliance that may trip you up, and how your business can best reduce organizational risk.

SALES AND USE TAX COMPLIANCE IS COMPLEX

Sales and use tax compliance can take center stage when companies seek new financing. Lenders want to know your business is in good standing with tax authorities in all states and countries you sell into. However, even the savviest business professional may find sales and use tax compliance confusing due to its complexity.

There are more than 13,000 sales and use tax jurisdictions in the U.S., each with its own rates and rules. And, as we mentioned in the M&A section of this guide, tax laws aren't static. For businesses to successfully navigate this decentralized and dynamic tax landscape, they must continuously monitor frequently changing regulations.

Determining where a business has nexus became more complicated with the U.S. Supreme Court decision in **South Dakota v. Wayfair, Inc.** in 2018. The ruling led to the creation of economic nexus laws in every state with a sales tax. With the rise of ecommerce and omnichannel sales, more businesses are discovering they've met state economic nexus thresholds and therefore established an obligation to collect and remit sales and use tax in additional states. Tracking how close your business is toward reaching a threshold gets even trickier because thresholds are subject to change when states pass new legislation.

MANAGING TAX EXEMPTIONS IS DIFFICULT

How well your business complies with requirements for tax-exempt sales can also be a factor when being considered for financing. But as with many aspects of tax compliance, managing tax-exempt sales can be challenging. Tax exemption regulations can change and **what's exempt in one jurisdiction may be taxed in another**. You may be required to register and file sales and use tax returns **even if you only have tax-exempt sales**.

Making sure you collect valid exemption certificates from all eligible customers is especially difficult if you don't have a reliable certificate management system in place.

GLOBAL STUDY

37% of companies surveyed in North America believe they are handling their exemption certificates very efficiently.

SOURCE: *Hanover Research*

BUSINESS LICENSE REQUIREMENTS VARY WIDELY

To lenders, your company's adherence to licensing and registration requirements is a basic measure of its ability to operate legally.

Unfortunately, keeping up with license and registration renewals can be difficult. There's no one place to get them and the more locations where you do business, the more states and local jurisdictions you need to deal with. Tracking renewal dates can be time-consuming for companies of all sizes.

As mentioned in this guide's M&A section, maintaining appropriate business licenses is even more complex if your business recently expanded or its structure changed.

PROPERTY TAX COMPLIANCE IS SUBJECT TO HUMAN ERROR

Property tax compliance is often a manual process. If your business made property tax compliance mistakes in the past, it could impact your ability to get financing in the future.

Staying on top of property tax compliance means being proactive, especially if your company hopes to obtain fair assessments and avoid penalties. But it's not easy. Managing return filings, **appeals**, and due dates for tax bills can eat up a lot of time, particularly if you're still using spreadsheets.

Different municipalities may use different methods for assessing property values. Without communicating your business situation to the assessor, you could end up overpaying. Plus, it's never a one-and-done determination; both real property and tangible personal property are regularly reassessed.

The CFO's compliance checklist for securing financing

Consider these guidelines to avoid tax compliance obstacles that could stand in the way of your business being approved for a loan.

- ☐ Turn to technology. Adopt a modern tax solution like **Avalara AvaTax** that's regularly updated to reflect changes in tax laws across jurisdictions. Automate compliance wherever possible to reduce risk.
- ☐ Conduct internal audits. Periodically review your tax compliance and exemption certificate management processes to catch any discrepancies.
- ☐ Maintain a current record of where your business has established nexus. An **Avalara Sales Tax Risk Assessment** shows you when and where you've triggered economic or physical nexus and need to register.
- ☐ Retain clear documentation of any correspondence with tax or licensing authorities, along with records of tax payments.
- ☐ Consistently review property tax assessments and challenge assessments when necessary. Document any appeals or disputes. **Avalara Property Tax** maximizes accuracy and automates the property tax management process.
- ☐ Keep a list of all active business licenses and registrations. Systematically track renewal dates and check that all licenses are current and valid.
- ☐ Review licensing requirements when considering operational changes.

Addressing audit risk

Audits are a top concern for many CFOs, and for good reason. The costs of preparing and responding to audits can add up quickly, and penalties can substantially damage a business's profit margin.

SALES AND USE TAX AUDITS

Certain companies and industries are subject to sales and use tax audits more frequently than others simply because of how they operate. Factors like high sales volume or many exempt sales can make auditors take notice. Auditors are also more likely to scrutinize your business if it has a history of failed audits.

Our **guide to sales and use tax audits** provides research-backed examples of the noncompliance areas auditors most frequently catch and tips to prepare your business. Read it for strategies that may save your company money.

Of course, there are other ways to potentially fail an audit. For example, using different systems for tracking sales and tax reporting can lead to discrepancies between records and filed returns if the data isn't integrated correctly.

Or, consider a business that sells products in bundles, with some items taxable and others exempt. A company with no solution to track laws and apply accurate tax only where applicable could make product classification errors.

PROPERTY TAX AUDITS

In addition to sales and use tax audits, businesses also have to **prepare for property tax audits**. While some states and jurisdictions have scheduled property tax audits, they can happen at any time.

Unfortunately, penalties for compliance errors are common. A 2022 **survey by Potentiate and Avalara** found that:

FOR REAL PROPERTY TAX	FOR PERSONAL PROPERTY TAX
41% of respondents owe penalties **25%** of the time	**51%** of respondents owe penalties more than **25%** of the time

The CFO's audit survival checklist

By recognizing potential audit triggers and addressing them proactively, your company can reduce the likelihood of penalties and ensure a smoother audit experience.

To mitigate risk, your business should do the following:

- ☐ Maintain meticulous records of sales and exempt sales transactions.
- ☐ Retain receipts and other documents related to the purchase and value of your real estate and personal property.
- ☐ Stay informed about industry-specific tax laws and jurisdictional rules.
- ☐ Implement robust tax compliance processes and tax compliance automation software.
- ☐ Seek guidance from a tax professional.

Reducing business risk with Avalara

Reducing organizational risk is easier with the right tools. Avalara is a leader in compliance risk management with solutions that can help your business make a smoother M&A transition, secure financing, and reduce audit risk. To learn more about how we can help your company, call 877-224-3650 or visit avalara.com.

Avalara makes tax compliance faster, easier, more accurate, and more reliable for 41,000+ business and government customers in over 75 countries. Tax compliance automation software solutions from Avalara leverage 1,200+ signed partner integrations across leading ecommerce, ERP, and other billing systems to power tax calculations, document management, tax return filing, and tax content access.

Visit **avalara.com** to improve your compliance journey.

DISCLAIMER

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