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CereTax - For Purchases (P2P)

White Paper - Solution Overview

Introduction & Purpose

This white paper is prepared as a discussion about the evolution and purpose of CereTax's purchase-side sales & use tax engine. The context of this paper will be technical in nature and is intended to explain the purpose and value of transaction tax automation with an emphasis on procure-to-payment transactions. "Front-end" sales and use tax ("SUT") processes are defined as those activities conducted by trained tax professionals to minimize tax liabilities and maximize corporate resources. The definition also extends to the initial determination of taxability and calculation of the amount of tax applied to taxable transactions. "Back-end" tax compliance is defined as those activities necessary to prepare multi-state SUT returns and administrative audits conducted by states.

Historical Context

The background of the developers of CereTax include a combined 60 plus years of experience as technology architects, public accounting tax professionals, industry tax analysts, tax compliance professionals, and state auditors. Over the years they individually recognized that a very wide gap existed between sales & use tax laws, rules & regulations, and the application of these laws and rules to transactional data. For many years, the only bridge to this gap was manual processes involving non-tax personnel charged with the responsibility of assessing SUT on transactions processed through financial applications. The basis of their tax decisions was limited to vague and inconsistent information disseminated by state revenue agencies. As a result, from the late 1970's through the mid-1990's, there was a large propensity by companies to over-tax transactions simply because there was a lack of knowledge or understanding about what makes transactions taxable versus exempt, or how much tax should be assessed for the various jurisdictions that levied the tax.

As knowledge about SUT began to expand (primarily due to huge deficiency audits by state and local jurisdictions), the public accounting firms along with some smaller boutique consulting firms began to recognize that substantial fees could be earned through engagements to represent taxpayers in audit defense and in calculating audit deficiency offsets and filing refund claims. Over time, the refund business became (and still is) a thriving industry with claims for some individual companies reaching into the **hundreds of millions of dollars**.

The Promise of Automation

In 1978 the first software application designed to calculate SUT was introduced by Vertex. Over the next few years other players entered the market including Taxware and Sabrix. The

initial offerings of these companies were designed to automate the calculation of tax on sales transactions. And eventually the SALT practices of the public accounting firms started partnering with these companies to provide implementation services. The collective goal of these applications was to reduce errors which would translate to reduced audit exposure and minimize overpayments. But the questions that remain today are “Why do so many errors occur in assessing SUT?” And “Why is the overpayment business still thriving?” CereTax, drawing upon a unique combination of skills necessary to effectively answer these seemingly simple questions, recognized the need for a focused solution.

Defining the Problem

In analyzing the causes of errors in taxation, one can see that the problem with SUT is that it is very subjective, very complicated, varies substantially from jurisdiction to jurisdiction, and changes rapidly. The problem is compounded for procurement transactions. Another dimension to the problem is in how the deficiencies or overpayments are manifested. The purchaser (or consumer) of an item or service is the party within a transaction that is ultimately liable for sales & use tax. A taxing authority can conduct an audit of both sales and purchase transactions and assess a deficiency on either party (whether the seller or consumer). However, a seller will have recourse against a customer to collect tax on a sales transaction after an audit assessment. Conversely, if an auditor assesses tax on a purchase transaction, the consumer has no recourse against the seller. As a practical matter, most audit errors (deficiency or overpayment) are discovered during the examination of purchase transactions. Consequently, an effective solution to the problem

ought to focus on where the effects are most prevalent – on the procurement or consumer side of the tax liability.

The Procurement Compliance Solution

The **primary** goal of an effective “front-end” sales & use tax solution should be to reduce, if not eliminate, errors in assessment of the tax that result in either an underpayment or overpayment of tax. To achieve this goal the solution should effectively bridge the gap between the multi-state SUT rules and the nature of a company’s specific transactions.

Secondary objectives of the solution, which will be discussed in detail in this paper, are:

- To streamline the audit function,
- Provide tax professionals with proactive visibility into the transactional data that is the basis for the company’s tax liability,
- Provide consistent and predictable taxability results,
- Centralize the administration of “front-end” SUT compliance with tax professionals skilled in multi-state taxation, and
- Provide output for *separate* “back-end” SUT compliance activities (return preparation, analysis and audit support).

CereTax for purchases is designed to be the focal point for all SUT procurement compliance activity. It is a tool for the corporate tax professional to effectively and proactively manage

the company's SUT liability. All "back-end" compliance work stems from the output of CereTax.

"Front-end" & "Back-end" Compliance – Opposite Sides of the Same Coin

Compliance is often thought of as a single process of everything necessary to effectively and accurately report SUT liability. However, compliance is really a set of sub-processes that start with the company's transactional data (as SUT is a transaction-based tax). Tax professionals find it very valuable to have a tool that enables them to analyze the transactional data proactively and to control the application of tax based on that analysis in a consistent and timely manner. It is the tax professional's skill at interpreting the tax rules and regulations and applying that determination to the transactional data that distinguishes "front-end" compliance as the much more valuable side of the coin. CereTax for purchases is the tool that allows the tax professional to capture his/her interpretations of the tax rules and then apply them consistently to prospective procurement transactions.

Achieve Pinpoint Accuracy - The objective is to get the taxes right

From a procurement tax perspective the first thing is to apply the correct taxability decision. In other words, is the transaction subject to tax or not? Other "back-end" focused applications that attempt to address the "front-end" place an emphasis on the calculation of tax and minimize the importance of the "front-end" determination, thus putting the tax professional in a reactive analysis mode. Getting the tax right at the "front-end" of the compliance process will yield increased cash flow because errors resulting in over and/or under payment of tax will be dramatically reduced, if not eliminated.

What does CereTax do?

Quite simply, from a functional perspective, CereTax automatically determines the taxable nature of individual transactions and calculates the amount of tax due on those transactions deemed to be taxable. From a value perspective, CereTax has the potential to **save a company millions of dollars in overpaid taxes, audit deficiencies, and lost time and opportunity.**

Let's look at some more detailed benefits of CereTax.

Single Point of Accountability

Often accountability for procurement-side tax determinations is decentralized among different parties. For example, the tax department may be responsible for interpretation and application of the tax rules and for compliance. The procurement department may be responsible for manual assignment of tax at the transaction level based on information from the tax department. And vendors are responsible for charging the correct amount of tax based on variables associated with the transaction, including exemption status and location and destination factors. As a result, the true nature of the transaction may not be correctly reflected in how the transaction ultimately gets taxed. CereTax automatically taxes all procurement transactions by creating a unique association between the specific tax rules and regulations and the accounting distributions assigned to the transactions (referred to in CereTax as a Multi-dimensional Rules Engine). The rules engine is configured specifically for each company during the implementation of the system by CereTax implementation professionals. Thus, CereTax creates a single point of accountability and eliminates non-tax personnel from the tax decision making process.

Reduction of Audit Defense & Recovery Costs

Through CereTax's unique rules engine, tax decisions are compiled centrally. Tax decisions are supported through the compilation of authoritative content that is stored and maintained by CereTax. Consequently, during an audit, each contested position can be readily defended with the appropriate documentation. The content of this data is a combination of laws, rules, regulations, hearing decisions, policy letters, and taxability requests.

CereTax can also be used as the focal point for alternative auditing techniques – saving even more time and money to administer and manage an audit. In some instances, the state auditor can base the audit results on a review of the tax rules that have been configured specifically for the company being audited. In doing so there is a dramatic reduction of required source documentation to support the audit results. These alternative techniques will also eliminate sampling risk because the auditor is effectively able to conduct a detailed review by virtue of an audit of the tax rules instead of the individual transactions. Examination of source records is limited to spot testing for completeness.

Eliminate Costly & Ineffective Training of Non-tax Personnel

By implementing CereTax and automating the determination and calculation of procurement transaction taxes, a company will no longer need to provide complicated tax training to non-tax personnel. Procurement personnel (buyers and accounts payable employees) can focus on correctly defining the nature of all transactions through the appropriate accounting distributions. The entire process is improved through more effective objective throughput of accounting information. CereTax also improves the lines of

communication between the tax department and corporate procurement by conveying distribution corrections rather than tax information.

Promote Valuable Proactive Planning Activities, not Costly Reactive Analysis

CereTax not only streamlines the entire compliance process, but it enables tax professionals to focus on activities that add value to the company. Poorly managed audits that require complex sampling procedures and volumes of source documentation are expensive. Likewise, decentralized tax determination processes lead to a propensity for overpayments that cost the company significant money in recovery fees to consultants and lost opportunity. Knowing the tax impact of overall procurement activity, including capital projects, can help the company make good decisions about how to structure transactions to minimize tax exposure. CereTax provides functionality and reporting that will enable these activities.

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