

CFO insights: Looking for Cash: Tap the Indirect Tax Opportunity

Traditionally, CFOs have focused on earnings and income taxes more than cash management and indirect taxes. But, as the credit crisis has turned the old rules on their head, CFOs are looking more closely at areas where value may leak from their organizations. One area that deserves renewed CFO attention is indirect taxes. Value leakages in this area drain cash, but past leakages create a tremendous possibility of generating refunds and recovering large sums of money.

Corporations pay a variety of different indirect taxes across various jurisdictions. Some of the largest indirect tax expenses can include value-added tax, sales tax and use tax. Other common indirect taxes include excise tax, fuel tax and payroll tax. Indirect taxes are also a global phenomenon and various countries are dealing with their own tax types, like Canada's consumption tax. Indirect taxes can also vary by industry.

Indirect taxes have received less attention in the past. Traditionally, large corporate tax departments have focused more on tax planning and optimization for income tax and earnings. They would only get involved in reviewing and optimizing indirect taxes when faced with a major audit of such payments. Often, the day to day responsibility for these taxes was neither centralized

nor part of the core tax department operations. In fact, responsibility for the compliance procedures for these taxes was often managed by non-tax professionals, so without careful scrutiny, companies often overpaid. Companies are suddenly realizing that there may be significant money available in indirect tax refunds. How much is at stake? Based on recent client work on indirect sales taxes, the opportunity is up to 2-3% of sales. This can expand with the consideration of other indirect taxes.

How can you access this potential cash from overpaid taxes? The first step is to conduct a reverse tax audit to identify overpayments. Two good areas to start a reverse tax audit are sales tax and use tax. Focusing on jurisdictions with very detailed legal considerations and rules is also a good idea. Given the complexity of the tax code in a jurisdiction, a company may habitually overpay by not scrutinizing the code and realizing all the exemptions. For example, Connecticut exempts some services from taxation but companies are often unaware of this and overpay. Another major area for recovery is use tax, where companies conduct all their purchasing and pay taxes in a certain jurisdiction, when they actually need to pay the use tax in the area of use. The difference in use tax across states could result in a significant sum.

Once a set of indirect tax opportunities and jurisdictions are initially prioritized, the next step is to identify overpayments. This requires a review of transactional data on sales and purchases. To maximize the recovery opportunity, begin with a sampling of the transactions using forensic accountants and consultants to quickly assess the opportunity. Then perform a cost-benefit on the jurisdictions and company product categories. Good access to detailed transactional data from the company greatly facilitates reverse audits and finding savings opportunities. This phase typically takes four to six weeks and is predicated on having most of the data accessible.



Once the recovery opportunity has been identified, the next step is to shepherd the framing and filing of amendments across jurisdictions. While the cash refunds do not arrive overnight, of course, they typically come within the same reporting year and could take upwards of six months. Nevertheless, adding a few percentage points to sales can be a significant cash opportunity.

While there may be many uses for cash recovered from tapping indirect tax overpayments, it is strongly recommended to pay careful attention to fixing the indirect tax compliance and accounting processes in companies. In recent years there has been a movement to migrate and centralize tax functions. The credit crunch is accelerating this process and provides a platform for moving decentralized indirect tax activities toward the center. However, beyond just tax process centralization, it is also important to address and ultimately stop overpayments. This means fixing internal processes and systems to better manage specific taxes and avoid future overpayment. Why take on the transformation of indirect taxes right now? Because indirect tax payments are more likely than ever to be in the cross hairs of tax authorities for audits. As tax revenues plunge in this recession, more tax authorities will be auditing indirect tax payments in an attempt to find every dollar that is due. Well-functioning systems that provide visibility into transaction data can greatly reduce the cost of responding to an audit.

The good news is many large companies have substantial opportunities to recover cash from overpaid indirect taxes. A small portion of the cash recovered can effectively fund the expertise required to efficiently recover the cash, as well as the people, processes and system transformations required to reduce value leakage from overpayment. Furthermore, it reduces downside risks in responding to future tax audits.

Synchronizing tax and business strategy has become vitally important in this credit crunch, especially as cash becomes king. Paying attention to indirect taxes is likely to provide some near term cash recovery benefits.

Deloitte's CFO Program harnesses the breadth of our capabilities to deliver forward thinking perspectives and fresh insights to help CFOs manage the complexities of their role, drive more value in their organization, and adapt to the changing strategic shifts in the market.

Deloitte's Eminence Fellowship Program offers targeted research and perspectives aimed at helping clients gain insights on market trends and find solutions to key business challenges. The research is developed through a highly-competitive, leadership development program designed to assist a select group of partners, principles and directors from across the firm's businesses transform ideas they are passionate about into tangible business strategies. Please contact Francine Fiano at ffiano@deloitte.com or at 203.708.4254 for more information.

Author

Scott Shafer
Partner/Principal
Deloitte Tax LLP
Tel: +1 214.436.3567
Email: sshafer@deloitte.com

Acknowledgement

This article was developed as part of the Deloitte Research Northeast Fellows Program with the assistance of Dr. Ajit Kambil, Global Research Director, Deloitte CFO Program, and Ameya Nagarajan, an editor with Deloitte Research.

For more information about Deloitte's CFO Program, please contact us at uscfoprogram@deloitte.com or visit our website at www.deloitte.com/us/cfocenter

This publication contains general information only and is based on the experiences and research of Deloitte practitioners. Deloitte is not, by means of this publication, rendering business, financial, investment, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte, its affiliates, and related entities shall not be responsible for any loss sustained by any person who relies on this publication.

As used in this document, 'Deloitte' means Deloitte LLP (and its subsidiaries). Please see deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries.

Member of Deloitte Touche Tohmatsu. Copyright © 2009 Deloitte Development LLC. All rights reserved.