SAP Concur

How to Reduce Risk and Manage Tax Compliance

IN A WORK-FROM-ANYWHERE WORLD

From our Achieving Outcomes series

THE BEST RUN SAP

Few events, beyond the Industrial Revolution, have transformed the way companies do business as profoundly as the COVID-19 pandemic. Commutes to the office and nine-to-five workdays are increasingly being replaced by work-from-anywhere models with flexible hours.

To compete for top talent in a tight labor market, many organizations are getting more creative with their compensation strategies — adding perks and pumped-up packages to attract and retain employees.

These factors have added another layer of complexity to the already challenging job of tax compliance. Finance departments have to ensure that appropriate taxes are paid on these new employee benefits, while staying on top of the various tax laws that govern the states and countries where employees live and travel — and do it all in an environment where the individual employee, not a centralized procurement department, is making the purchase.

The reason? Just like the business entities they oversee, tax authorities have been leveraging technology to become more effective themselves.

“Twenty years ago, when people relied on manual ledgers, doing audits and identifying tax gaps were a lot more difficult and time consuming,” explained Alberto Herrera, Senior Value Consultant at SAP Concur. “Today, because of technology, there’s much more transparency. Tax authorities have access to more data, and the ability to quickly drill down into the details of that data. They can also easily share that information with other tax jurisdictions on both the state and federal level — something that was difficult to do before.”

Not only do tax authorities have the tools and technology to more effectively track organizations that are out of compliance, but, they’re also more motivated to do so.

“These tax jurisdictions are coming out of a pandemic where economic stimulus and lost opportunities have cost their jurisdictions millions, billions and, in some cases, trillions of dollars. So, there’s a big deficit,” Herrera said. “They’re looking for ways to address that tax gap and bring in additional revenue to balance out that shortfall.”

How can organizations adjust their approach to tax compliance management and spend oversight to meet the challenges of today’s business environment? What can they do to decrease vulnerabilities, while ensuring they capitalize on all the tax reclamations the company is entitled to? What actions should they take now to protect their company for the long term in an ever-evolving compliance landscape?

We spoke to some industry experts to find out.

Employee Benefits: The Work Behind the Perks

Managing employee benefits tax is not a new challenge, but one that's gotten far more convoluted for several reasons.

"Organizations are now getting more creative with the benefits they offer, both to attract new talent and provide a more inclusive, exciting workplace to retain the talent they have," Herrera said. "But, every time they introduce a new benefit, they have to identify if that benefit is taxable, which isn't always as simple or straightforward as it sounds."

While there are federal guidelines on what's taxable and what's not, some states, like California, have additional regulations on top of the federal mandates. So, if your company has a "work from anywhere" model, you may have employees who voluntarily relocated to another state, or have new hires working across the country or around the world.

"You have to know where your employees are based, whether that gives you a taxable presence in those areas, and what the requirements are," Herrera said. "What are you obligated to file now that you have an employee residing in that state or country as their tax home?"

The fact that most of these new benefits are being expensed by employees instead of centrally managed, like more traditional benefits, adds another layer of intricacy.

For example, let's say an organization starts offering gym membership reimbursements, up to $75 a month, as a new employee benefit. Instead of adding $75 into payroll for every employee, the company leaders decide to let employees expense their gym memberships, up to the $75 limit; knowing that some employees won't take advantage of the benefit at all, and others might choose to join lower-cost gyms. Expensing it is a more cost-effective way for that company to provide the new benefit.

The downside is the organization now must put a mechanism in place to track those expenses so it can pay the appropriate tax in all of the various tax jurisdictions that apply.

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Whether or not a benefit is taxable can also be a gray area in certain circumstances. For example, parking can be considered a taxable or tax-exempt benefit, depending on where exactly that employee is parking.

"If you have a $5 charge for parking at your office location and you give your employees $5, that's not a taxable benefit. However, if you provide that $5 for an employee who is parking at a train station in Connecticut, and taking that train into the office in New York, that is considered a taxable benefit," Herrera explained. "The challenge is both of these items would probably be expensed under the category of parking. But, one is taxable and the other is not."

Organizations need an efficient way to quickly differentiate between the two costs versus benefits, or they could incur penalties down the road.

EXAMPLES OF TAX-EXEMPT EMPLOYEE BENEFITS INCLUDE:

- Health insurance
- Disability insurance
- On-premise meals
- Workplace parking
- On-site gym
- Adoption assistance
- Education reimbursement, up to $5,250 a year

Source: IRS.gov

Spend Management: Maintaining Compliance In a Decentralized Workplace

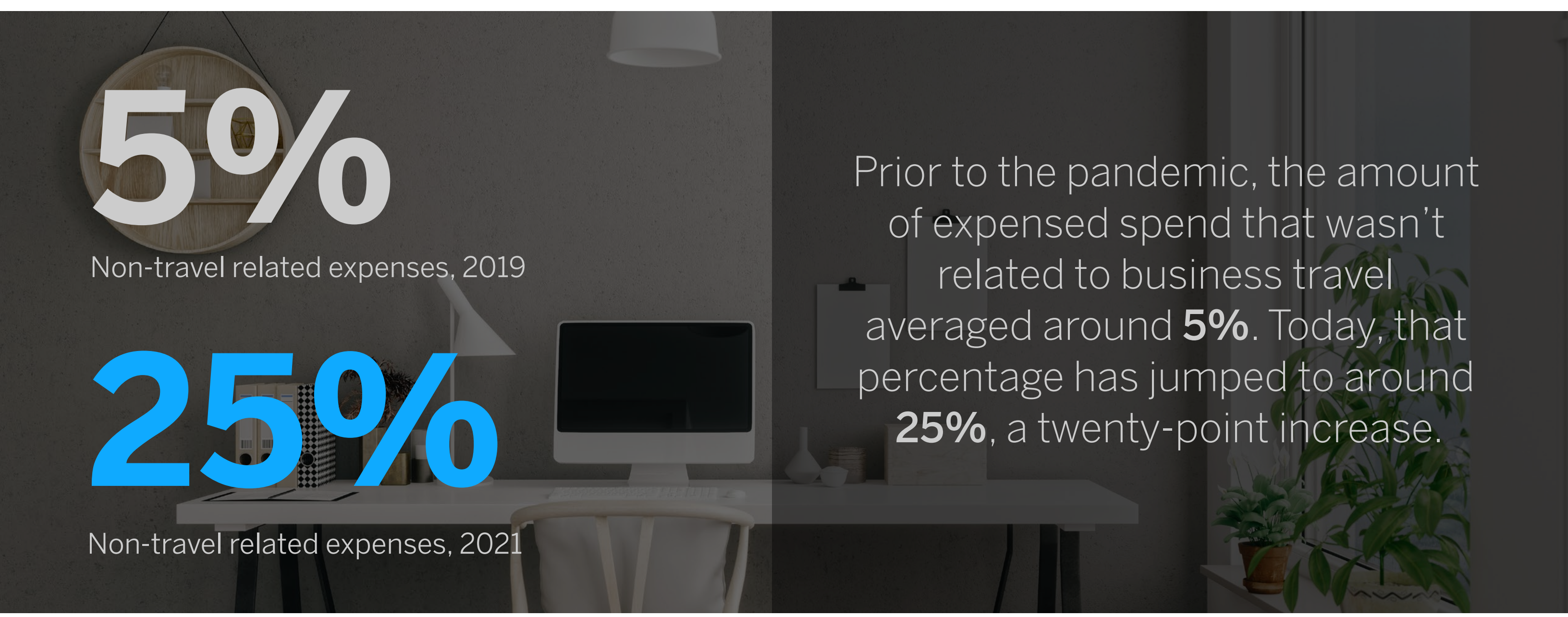
Prior to remote work becoming the norm, many organizations had their Travel and Expense (T&E) management down to a science. They knew where their employees were traveling and what they were expensing while traveling. And they had tight controls in their expense management system, workflows, and processes to govern compliance.

For many finance organizations, the pandemic, the shutdown, and a widespread office migration turned that well-oiled compliance machine upside down.

“Instead of submitting airfare, hotel, and travel meals, employees were submitting expenses for work-from-home peripherals, desks, monitors, chairs, and internet services, so programs and controls had to adjust for that, as well as processes,” Herrera explained.

Prior to the pandemic, the amount of expensed spend that wasn’t related to business travel averaged around 5%. Today, that percentage has jumped to around 25%, a twenty-point increase.[1]

Travel costs, for example, used to account for 65% of expense spending in 2019, according to internal SAP Concur customer data. But with outfitting remote offices, the proportions have shifted, and travel now accounts for only 33%, while ‘miscellaneous stores’ accounts for almost 24%.



With that has come an increase in the dollar value associated with policy violations, and a higher propensity for procedural errors, like failure to include a receipt for the purchase. So, the need for diligence has escalated along with these non-travel-related expenses.

"That increase means there's a whole variety of spending coming through that no longer suits a scaled human process. Instead of a series of hotel receipts coming through, with similar information, companies are taking in expense reports in which every single line could be different," explained Dr. Mark Stirling, Senior Vice President of Global Channels at Blue dot. "So, there's a greater level of scrutiny required that just can't be handled by previous manual processes or workarounds. That 'other' category has become too big a part of the spend data now that it can't be overlooked."

Companies also have to address how exactly they're going to manage the office equipment being purchased.

"Is the desk company property, or are you giving it to the employee? When an employee leaves, do you expect that desk, that chair, and everything purchased for the home office back?" Herrera said. "If so, you need a process for that, as well."

Although policy violations were down in 2021, the dollar amount associated with these violations increased.

THE MOST DOMINANT VIOLATION TYPES WERE:

21.8%
Excessive personal expenses

26.7%
Expense header keyword match

58.6%
Excessive missing receipts

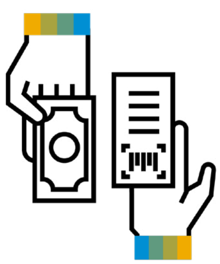
Source: 2021 Spend Insights Report: A Better Understanding fof 2021 for a Better View of 2022, SAP Concur and Oversight

Value-Added Tax (VAT): Making a Strong Recovery

Value-added Tax (VAT), also known in some countries as a Goods and Services Tax (GST), is a consumption tax that is levied on products and services incrementally, at every stage of the supply chain, from production to distribution to the point of sale. Here's how it works: every step along the supply chain is taxed, until the product or service is sold to the end consumer, who is ultimately responsible for the tax. Every business along the value chain can receive a VAT credit or reimbursement for the tax already paid, if that business goes through the reclamation process.[1]

There are two categories of VAT that apply to T&E management: Domestic and Foreign.

DOMESTIC VAT

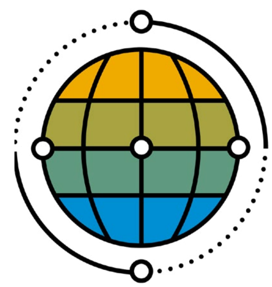


Domestic VAT is the employee-based spend that happens in that employee's home country.

So, if an employee in France makes a purchase there, and his or her employer can prove that expenditure had a valid business purpose and qualifies for reimbursement under that nation's VAT requirements, the company can get those funds back in the form of a deduction on its next tax return.

"You can describe the process as a trust system, but the authorities can come in and audit to check the controls you have in place," Dr. Stirling said. "If controls are lacking, authorities can impose sanctions leading to fines and penalties for non-compliance. Of course, a bigger concern is ending up on the authority's blacklist, or ending up in the news for those VAT challenges."

INTERNATIONAL, OR FOREIGN, VAT



International VAT, also called Foreign VAT, pertains to the taxes on the spend accrued by non-resident business travelers in any of the 160 countries operating under a VAT system.

So, if a German national travels to the UK on business, those expenses, if properly tracked and documented, could be submitted for reimbursement to the proper authorities in the U.K. for a refund—this time paid as actual monetary funds, not tax credits.

Getting this refund isn't easy, or fast.

The employer must cull through the expense reports, audit and qualify eligible expenses, and then demonstrate that the spend was incurred during business. All this data is submitted as a line-itemized request to each country's tax authority for VAT reimbursement.

THE RECLAMATION DILEMMA

Although VAT reimbursements benefit organizations by funneling funds back into increasingly tight budgets, [around 54% of eligible VAT reimbursements are never claimed].[2] Businesses that rely on manual processes simply don't have the bandwidth or expertise to manage this time-consuming reclamation process on their own.

Just keeping up with each country's different requirements is a challenge in itself. In Spain and Portugal, the purchasing company's VAT ID has to be on the invoice for reclamation. Other countries vary the percentage of tax reclamation based on the circumstance. For example, in Denmark, companies can reclaim only 25% of a restaurant meal, but recoup a full 100% of catering expenses for business meetings or conferences. In Germany, different VAT rates apply for taxis and public transportation, and vary based on the distance of the trip.

There are also local rules around what types of spend are eligible for VAT reclamation. In some countries, the VAT paid on hotel rooms are reimbursable, but in France, they are not.

In addition to keeping track of all these nuanced rules, organizations have to ensure their submissions won't be disqualified because the employee put the wrong address on a receipt, was missing information, or failed to include the right documentation.

In light of 42% of employee expense transactions failing to meet the requirements for VAT reclaim due to incorrect information or missing data[3], maximizing VAT reclamations in a manual, people-driven environment is easier said than done.

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Dr. Mark Stirling, Senior Vice President of Global Channels, Blue dot

NAVIGATING THE BLURRED LINES OF BLEISURE TRAVEL

The new work-from-anywhere models are also blurring the lines between business and leisure, particularly in the area of travel.

Now that travel restrictions have lifted, more employees are tacking days onto their business trips, either staying the weekend after or arriving the weekend before to see the sights. But how can companies determine if that weekend of hybrid "bleisure" travel is a taxable benefit, or if those expenses are eligible for VAT reclamation?

The short answer: it depends.

"If someone in the UK has a business trip from Wednesday to Wednesday in Australia, there's no way he or she is going home for the weekend. In that scenario, it's easy to say the employee expenses are for valid business purposes," Dr. Stirling said. "But, if that UK-based employee travels to France, and tacks on an extra two days at either end, that's probably considered personal spend whether the employer reimburses it or not."

So, weekend expenses from the first trip would be eligible for VAT reclamation. The weekend expenses from the second trip would not be eligible for VAT reclamation, although, if the company reimbursed those weekend expenses, they should be routed to payroll as a taxable employee benefit.

If the employee paid for his or her own weekend expenses with no company reimbursement, then these are not eligible for VAT reclamation, and are not considered taxable employee benefits.

The net-net? Companies must now look beyond receipt contents alone and to the context of the travel event surrounding those purchases.

The Starting Point: Action Items for a More Compliant Future

So, what can companies do today to improve compliance, mitigate risk, and position their organizations to be tax compliant for the future? Our experts weighed in with this checklist:

1. REVIEW YOUR CURRENT POLICY

Organizations should review their policies on a semi-annual or annual basis, look at the expense types being used, then identify if any expense types are under-utilized and find out why.

"It's also important to pressure test your policy," Herrera said. "If you have a meal limit in place, go in and see how many times that meal limit was exceeded, or whether the average is much lower than what the meal limit is. Do you need adjustments? And, are the expense categories reflective of what your current policy actually says?"

2. UNDERSTAND THE TAX IMPLICATIONS OF THAT POLICY

When you add a new employee benefit, have conversations with your tax department and payroll department beforehand to understand the tax implications of the new benefit, and how you're going to account for that tax.

Are you going to gross up and pay the tax for your employee, or are you going to let the tax burden fall on your employees and add it to their W-2?

"Working all of those details upfront not only prevents unhappy surprises down the road, but also helps you with budgeting, because you know the true cost of the benefit," Herrera explained. "If you're going to gross it up, a $75 gym membership isn't going to be a $75 line item. It's $75 plus tax."

Regular communications with your tax department ensure you stay on top of changes that impact your T&E program, so you're not retroactively adjusting entries when, six months down the road, you learn you've been applying the wrong tax rate to an expense type.

3. DISSECT YOUR REJECTED EXPENSE REPORTS

Identify why you are rejecting expense reports. Is it one area that's causing the majority of rejections? If so, maybe some employee re-education is in order.

Also, check to be sure the messaging in the system matches the guidelines in your policy.

"Make sure your audit rules align with any policy changes you might have made, or your employees will be getting the wrong prompts when they go to submit," Herrera said. "When you have a global program, that need for alignment gets even more critical."

4. ENSURE YOU HAVE ADEQUATE CONTROLS IN PLACE

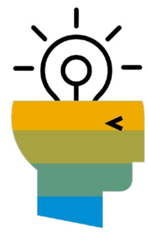
If you have taxable employee benefits that regularly go through your expense system — like employee gifts and rewards — make sure you have controls in place to ensure there's not a misclassification.

"An easy way to identify a gift or reward that's erroneously misclassified is to require a business purpose on those line items. Then, do a keyword search on business purpose," Herrera said. "You might find the word 'gift' by a line item in office supplies or miscellaneous."

And don't limit these checks to domestic expenses.

"You have to communicate with your tax experts in every country or geographic region to make sure they understand what you're allowing to be put through the system, and have a process in place to report these in line with the regulations in their country or tax jurisdiction," Herrera said. "If your organization has a global footprint, it's your responsibility to have that global control in place, as well."

5. EDUCATE YOUR EMPLOYEES



Make sure you keep your employees in the loop — educating them on your policy, tax changes, process changes, and what they can do to improve spend compliance or aid your reclamation efforts.

"The absolute best compliance tool you can have is an informed employee," Herrera said. "Ensuring they are aware of what your policy is, where they can locate it, and how they should be doing things is critical. 99% of your employees want to do the right thing. Keep them informed, and give them the right tools, and most will stay within your guidelines."

Use the controls you've put in place to identify the outliers, and then reach out to them to explain what they did incorrectly, and how to categorize or document the expense correctly.

These five steps lay the foundation. Then, by applying the right technology, automation, and services, organizations can move from risk to reward.

The Endgame: Using Automation and AI to Simplify and Streamline Tax Compliance

"You can lay all the groundwork, update your policies, and set up all of the data correctly in your expense management system, but, if you are still setting up tax tables in spreadsheets, updating rates, and trying to manage that part of the process manually, you're probably not going to have the outcomes you want," Herrera said. "Even if you do have enough people on your team able to identify and manage 80% of your taxable benefits or recovery opportunities, they're simply not going to be able to do as much as a tool that incorporates AI, machine learning, and OCR technology."

Instead of the human stare-and-compare approach, an automated, AI-powered tax solution sifts through each receipt to understand the context of the expense and applies the appropriate tax rules for either VAT or a employee benefit to ensure the expense is processed correctly.

"You'll remove the complexity by taking the people out of the process, automating the process, and applying a consistent rule set to the data as it works its way through," Stirling said. "You'll also have fast access to the dashboards and reports you need to drive continual improvement."

With this approach, organizations can now focus their employees on higher-value, more strategic work, while improving outcomes.

"With the data access available today, you just can't plead ignorance anymore — and you can't rely on the way you've always done things," Herrera said. "The tools and technology for more effective compliance management are out there. By taking advantage of them, you can give your employees and your staff the tools they need to do their jobs accurately and efficiently, protect your company from risk, and adapt to this new business environment."

For more information on how SAP® Concur® solutions can help your organization automate your tax compliance process to reduce risk, recover funds, and free your staff from tedious, manual processes, please visit our **tax solutions page** and our **benefits solution page**, or contact your Client Success Manager.

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SAP® Concur® is the world's leading brand for integrated travel, expense, and invoice management solutions, driven by a relentless pursuit to simplify and automate these everyday processes. The highly-rated SAP® Concur®mobile app guides employees throughbusiness trips, charges are directly populated into expense reports, and invoice approvals are automated. By integrating near real-time data and using AI to analyze transactions, businesses can see what they're spending, improve compliance, and avoid possible blind spots in the budget. SAP Concur solutions help eliminate yesterday's tedious tasks, make today's work easier, and support businesses to run at their best. Learn more at concur.com or the SAP Concur blog.

SOURCES:

[1] Tax Foundation: https://taxfoundation.org/tax-basics/value-added-tax-vat/#:~:text=A%20Value%2DAdded%20Tax%20(VAT)%20is%20a%20consumption%20tax,a%20tax%20on%20final%20consumption.

[2] Viable For Vat? An SAP Concur Conversations Podcast with Blue dot.

[3] Simplifying Your VAT Reclaim for T&E Program Resilience, Kyla Kent for the SAP Concur Blog

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