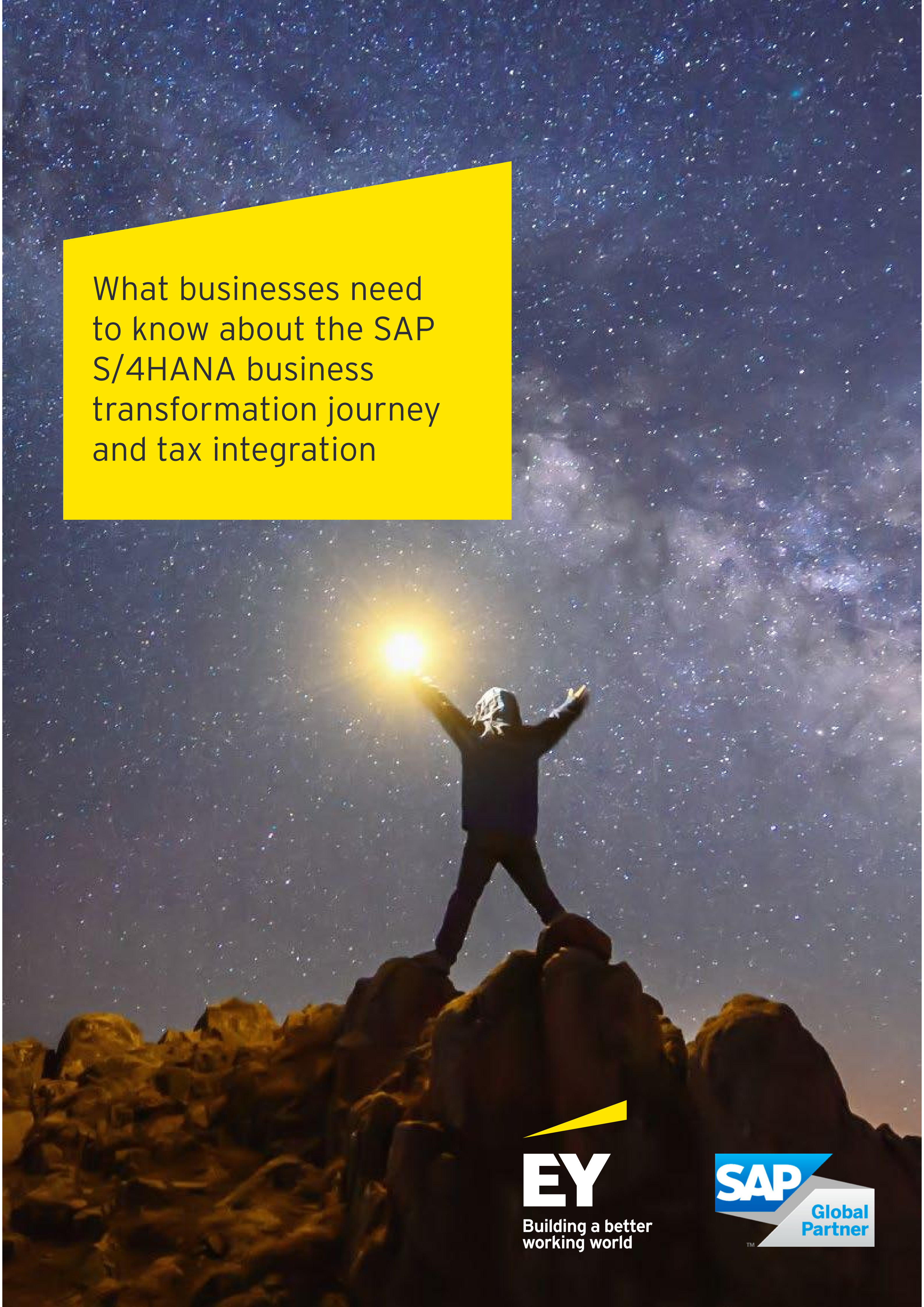
What businesses need to know about the SAP S/4HANA business transformation journey and tax integration



Building a better working world

SAP Global Partner

Contents

1 Introduction

Technology and finance leaders whose organizations are implementing **SAP S/4HANA** often assume the following about the tax function's involvement and impact:

1. We are meeting the tax function's needs.
2. The tax scope is limited to indirect taxes: VAT/GST, sales taxes, customs duties and withholding taxes.
3. Industry templates and accelerators that the system implementer (SI) will use are the leading practice for tax functionality across the program.

These false assumptions significantly limit the ROI of their business transformation journey with SAP S/4HANA and IT investment, resulting in lost transformation value, long-term operational inefficiency and increased enterprise risk.

Through our work with multiple multinational organizations across industry sectors, we have seen firsthand how leading companies drive significant enterprise value by fully incorporating the tax agenda within the program scope early in the process.

In fact, realizing the full potential of tax in an SAP S/4HANA implementation demands a dedicated tax integration strategy, focused on ensuring there is a robust solution design in place for direct and indirect tax needs. The tax solution design should also consider the transformation of future state finance, tax, supply chain and procurement processes necessary to realize value.

> Realizing the full potential of tax in an **SAP S/4HANA** implementation **demands a dedicated tax integration strategy,** focused on ensuring there is a robust solution design in place for indirect and direct tax needs.

2 Early SAP implementations and tax (non) integration

Operational and finance transformation

are the key objectives for most SAP projects, and technology enables the change.

This focus leads companies to rank other priorities before tax, such as:

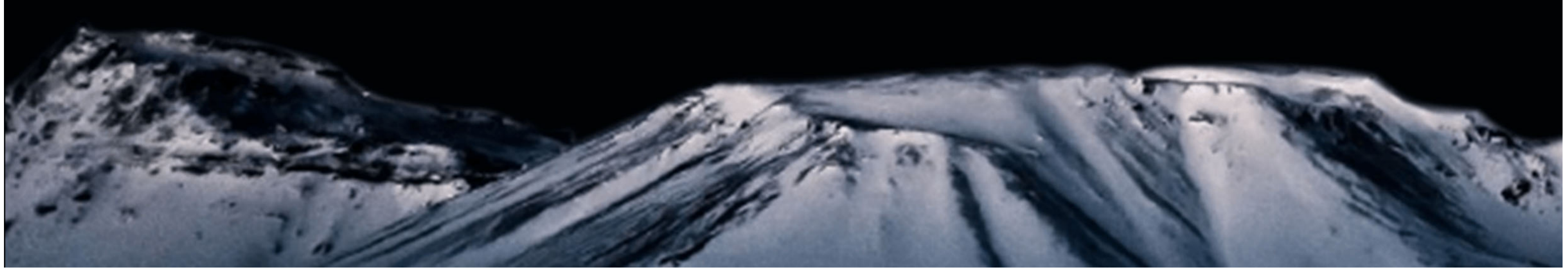
External consolidated reporting:
the 10-K for US publicly traded companies

Operational finance: sales, accounts receivable, accounts payable, working capital and logistics

Internal management reporting and planning

US multinationals typically rank the ability to deliver robust statutory (e.g., local GAAP) accounts on a legal entity basis last and often omit the task from program scope or heavily de-prioritize it. Many corporations still rely on spreadsheet processes or third-party service providers to manually create their local GAAP accounts.

From a tax perspective, indirect taxes align to the operational finance agenda and are often associated with regulatory compliance. This explains why they have always been elevated in the minds of finance IT program leadership. It is rare to find a legacy SAP environment where these taxes are not enabled to some significant extent at the system level. Perfect no, but usually good enough.



Direct taxes, which are primarily calculated by reference to legal entity accounts, have been a casualty of the de-prioritized approach to statutory reporting.

The data either has not been there or, most commonly, not accessible centrally, **leading to a combination of:**

1

Heavy reliance on local financial controllers and planners to provide information through tax packs or other ad hoc reporting approaches

2

Extensive use of manual/spreadsheet-based processes within the tax function to support compliance, tax accounting, planning, controversy and tax-driven transaction execution

3

Custom databases/cubes or point solutions to aggregate tax-relevant information

4

Considerable dependence on external service providers to bridge the resource gap

A tax function

spends up to 70%

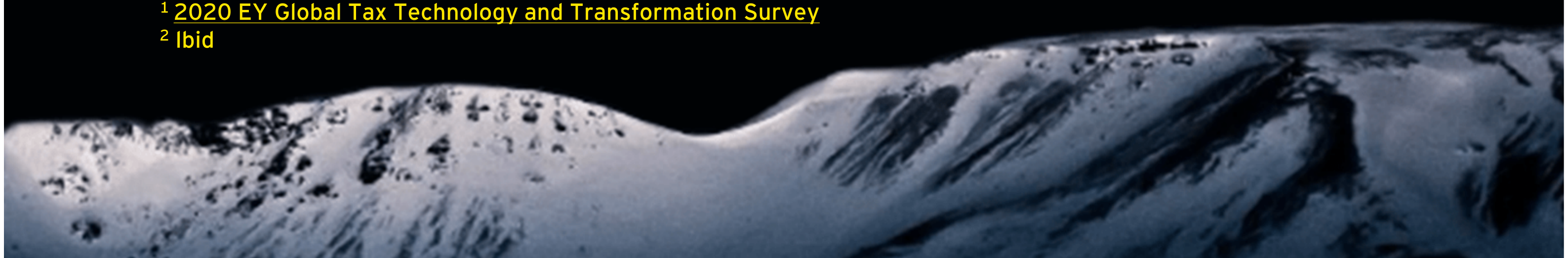
of its time on data cleansing.[1]

The consequence?

Tens or hundreds of thousands of hours are spent wrangling data across finance and tax, elevated enterprise risk, additional IT complexity and cost and excessive consulting fees. It is well known that a tax function spends up to 70% of its time on data cleansing and manipulation.[2] For the vast majority of companies commencing their SAP S/4HANA business transformation journey, the direct tax side is woefully underserved by their legacy ERP system, especially considering that direct taxes are typically among the top five expenses that multinationals face.

This is an extraordinary mismatch between economic impact and system support.

[1] 2020 EY Global Tax Technology and Transformation Survey
[2] Ibid



3 How the tax functionality gap became a chasm

The last decade has been characterized by some of the most widespread tax changes in recent memory. At the supranational level, the OECD's Base Erosion and Profit Shifting (BEPS) project and BEPS 2.0, as well as action by the European Union, has led to a host of international tax compliance and reporting proposals that cascaded down to jurisdictional regimes.

Combined with the Tax Cuts and Jobs Act of 2017 and the Biden Administration's tax plans, this is the most complex tax landscape in history for companies with large US footprints, outbound or inbound. Most notably, to effectively comply with the current and emerging direct tax landscape, companies must be able to collate and analyze transactional data at a level of granularity never previously required.

If legacy systems were unfit for tax purposes in the past, they are even more unfit for the present and the future.

The indirect tax landscape is also shifting. On the customs side, the United States-Mexico-Canada Agreement replaced the North American Free Trade Agreement, and tax authorities' expectations regarding real-time reporting of transaction-based taxes has never been greater. This continues at an accelerated pace. If legacy systems were unfit for tax purposes in the past, they are even more unfit for the present and the future. The business transformation journey using SAP S/4HANA provides the opportunity to align core ERP capabilities with tax's future needs.

4 The risks of leaving tax value on the table

Considering the profitability and liquidity impacts of direct and indirect taxes and the extreme complexity that now needs to be navigated, tax functions are positioned to add significant value to the corporate planning agenda. There is a presumption that tax departments are able to pivot, yet for most, this is largely impossible with their legacy ERP systems.

As outlined above, tax is mired in manual processes. Highly trained professionals who are uniquely poised to analyze, anticipate and plan are instead overwhelmed with data jockeying.

Sixty-five percent of tax functions view the lack of a sustainable plan for data and technology as the biggest barrier to transformation.[3]

In our experience working with leading companies, the financial benefits of appropriately including tax within an SAP S/4HANA implementation can be **highly significant:**

1 When the full organizational effort across tax, shadow tax and finance functions is assessed, the potential full-time equivalent (FTE) efficiency from tax-sensitizing data at source can easily exceed **100,000 hours**.

2 Eliminating or minimizing the need for tax-specific data solutions can reduce IT infrastructure and maintenance costs.

3 Tangible risk mitigation leads to fewer fines, penalties, adverse tax audit adjustments and external advisory costs associated with protracted litigation.

[3] Ibid

When the **SAP S/4HANA** landscape is appropriately configured to align and integrate the different tax processes with activities within treasury, controllership, and financial planning and analysis, it creates the opportunity for multiple win-win scenarios. The benefits exceed FTE efficiency and include balance sheet monetization, operational liquidity enhancement, reduced foreign exchange exposure and costs, and reduced operating expenditure.

However, just because an **SAP S/4HANA** implementation has the potential to yield such value, does not guarantee it will. In many cases, retrofitting tax-efficient operational models to legacy systems is cost-prohibitive. An **SAP S/4HANA** implementation provides an appropriate opportunity to implement previously rejected planning functionality. Fully sensitizing SAP for tax is not achieved through a single program work stream or the adoption of a specific module — it requires comprehensive and holistic integration of tax requirements within the overall program scope. This means addressing the tax solution design of master/transactional level data all the way through to consolidation and business intelligence/analytics.

SAP S/4HANA

5

Why the **system implementer** cannot do it all

When first engaging with a prospective systems implementer (SI) team, it is common to hear them say that tax is within their scope. This raises several questions, such as the following: Which taxes do they mean? Are they limiting the transformation to indirect taxes? As noted above, some of the biggest functionality gaps in legacy ERP systems – and value opportunities in SAP S/4HANA – have a significant impact on direct taxes.

It is important to understand the SI team's experience, the suitability of their templates and accelerators, and their ability to cover all of the work necessary to fully integrate tax into the future state SAP S/4HANA system.

1

Does the SI team have the following experience:

- Inventorying the manual/tactical tax data management strategies and point solutions that global tax functions use to maintain base-case functionality?
- Identifying and quantifying the tax value from an SAP S/4HANA implementation, including interdependencies within the organization and the points of connectivity to program work streams?
- Optimizing end-to-end processes necessary for compliance, tax accounting, planning, controversy and tax-driven transaction execution, and linking the realization of transformation value to enabling capabilities from SAP S/4HANA and the extended SAP S/4HANA application landscape?

2

Do the SI's templates and accelerators:

- Incorporate detailed tax requirements from both a global template and localization perspective for current and proposed laws and regulations across all tax types and jurisdictions?
- Address leading practices for typical tax-efficient operating models common in your industry sector?
- Contemplate the integration of tax-specific software into the overall system design?
- Include knowledge of proposed regulations across the globe?

3

Does the SI have qualified personnel budgeted to (or do they just assume that the tax department will provide all the insight and knowledge of SAP for Tax):

- Help draft detailed tax requirements and user stories?
- Robustly assess how well tax user needs align with 'fit to standard'
- Participate in all relevant work stream meetings?
- Develop tax-specific test scripts for user acceptance testing and system integration testing cycles?
- Optimize tax deductibility of the overall SAP implementation expense on a global basis?

The answers will reveal whether the SI has comprehensive tax knowledge and the ability to apply it to the detailed technical context of an S/4HANA program. It will also become clear whether the SI is assuming that the tax department will provide all the insight and knowledge of SAP for Tax. In our view, Most Sis cannot do it all.

4

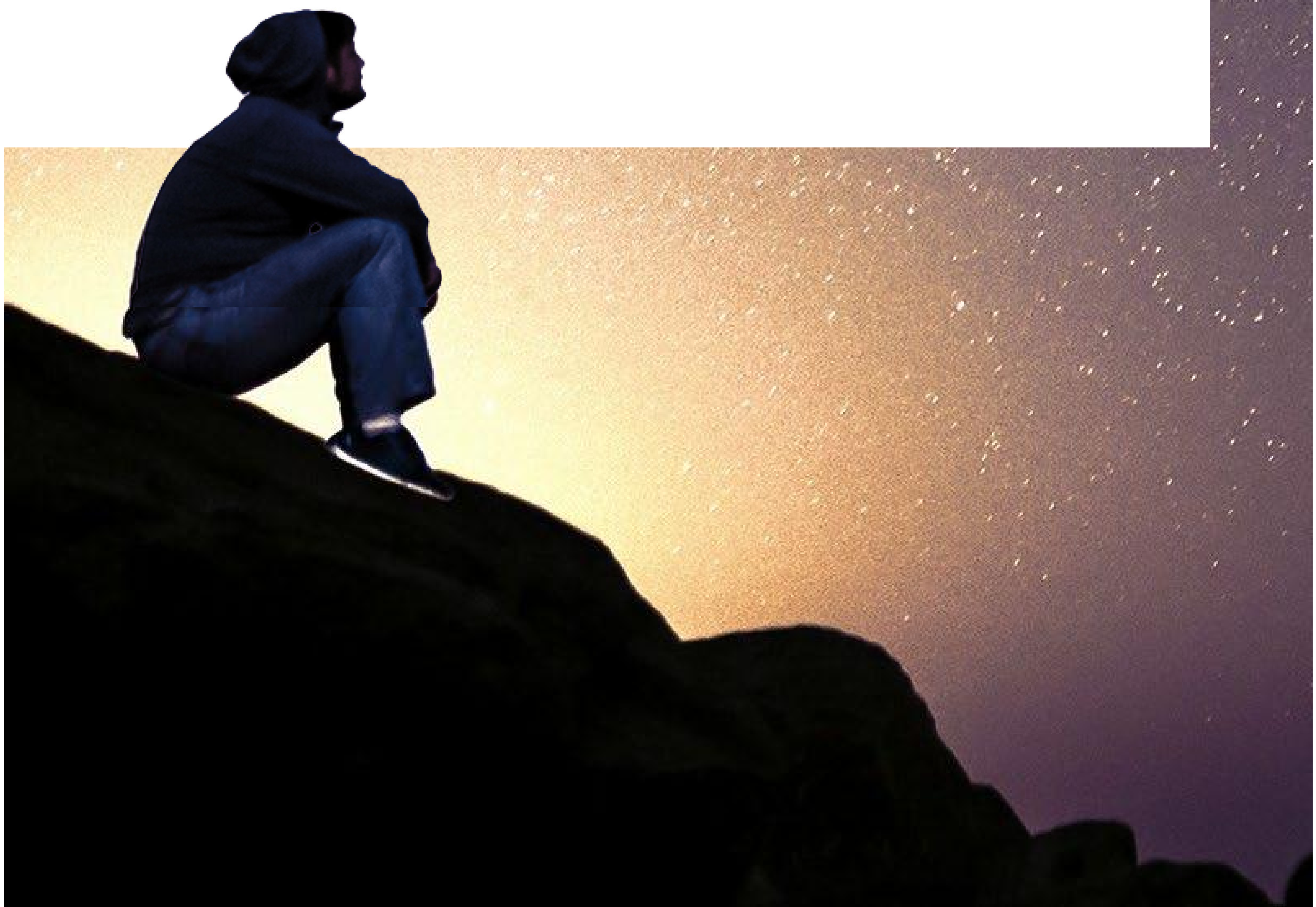
Finance and IT leaders should therefore consider bringing in a team of SAP tax integration professionals to help throughout the S/4HANA journey, and who will:

- Help quantify the tax value to include the overall program business case
- Advocate for the tax function, demonstrating how the capabilities of S/4HANA match their needs
- Identify practical workarounds for tax processes when system-based enablement is technically challenging
- Represent tax during all relevant program meetings and workshops
- Translate SAP and tax requirements, and document tax technical requirements across Record to Report, Order to Cash, Purchase to Pay, Supply Chain, and associated future processes.

6 **Conclusion:** the future of business with tax-sensitized SAP S/4HANA

How can tax-sensitized SAP S/4HANA enhance the ROI from an IT program? The starting point for finance and IT leaders is to bring tax stakeholders into SAP road map discussions as early possible and give them an opportunity to quantify the tax value case.

As the program progresses, tax should receive sufficient resources to fully participate in the business transformation program, from conception to launch. Companies that fail to comprehensively include tax within their SAP S/4HANA implementation significantly limit their opportunity to maximize transformation to value for the enterprise.



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