

Adopting Innovative Tax Technology to Improve Business Performance and Mitigate Risk

Surmounting Lease Tax Compliance Challenges

Executive Summary

The motor vehicle and equipment leasing industry has been growing at an exceptionally fast pace spurred by innovative program development, creative channel and distribution arrangements, and a global economy. In addition, customer demand has caused banks, finance companies, and captives to offer an ever-increasing array of financial products and services. As a result, leasing companies are requiring more flexible and robust systems to support large portfolios, an abundance of financing options, and intricate contract management.

Survival for companies in this environment means operating smarter, faster, and more efficiently. Profitability depends upon the introduction of new products and services. And the leaders are those getting their products to market faster. The accelerated pace of the leasing industry has in turn elevated the need for finance and IT departments to ensure data accuracy, consistency, and availability.

Since financial data plays a pivotal role in leasing transactions – from origination through servicing and reporting – having accurate, consistent data matters. More than just daily operational activities, data also impacts business strategy and clean, reliable data aids compliance.

In recent years, corporate mismanagement in the financial industry has led to increased regulatory mandates. These regulations, compounded by industry-specific lease tax nuances, have heightened scrutiny on compliance processes and have intensified pressure on the tax department.

With more than 7,000 tax jurisdictions in the U.S., making anywhere from 300–600 tax rate changes in any given year, the task of accurate data management, the bedrock of all compliance activities, becomes mission critical. International companies juggle an even greater load with country-specific indirect taxes that are also updated frequently. Layer on changes in the application of very specific tax rules to these rate updates, and managing data integration and data quality has never been more challenging.

Tax departments are often left to manage their audit exposure with legacy systems and inefficient, time-consuming processes that rely heavily on manual input. The inflexible nature of aging tools and manual processes make rules and logic updates difficult and the lack of standards embedded in the design of older systems makes integration

with other systems – old and new – problematic. Manually applied rate updates are error-prone and Excel spreadsheets, once hailed as efficient and easy-to-use, are now inadequate for supporting complex operations and the demands of compliance reporting.

A 2007 study by Capgemini, in collaboration with the Equipment Leasing and Finance Association, notes, “The ‘wait-and-see’ era of technology investment is over. Half of the survey respondents indicate that the next eighteen months will be a game-changing period . . . enabled by technology.” The study goes on to propose, “The catalysts for change include vendors making recent advancements in their solution offerings, coupled with companies that are increasingly tying IT initiatives to business strategies.”

The motor vehicle and equipment leasing industry requires the use of next-generation tax technology to support its burgeoning operations. Today’s environment demands that companies do more with less, which means expansion does not always include an increase of internal resources. This is where improved solution offerings can yield cumulative results. And unlike the past, the technology demands of today’s leasing company are more than just automation of manual processes. The new systems must help improve the overall business process and ensure compliance to help meet the growing demands of customers, stakeholders, and regulatory authorities in an increasingly complex industry.

Tax Technology Drivers for the Leasing Industry

Leasing companies are looking to upgrade their systems for gains in data quality, process control, and reporting flexibility. In addition they are striving to align their IT investment and priorities with their business strategy and are looking for technology solutions that:

- Automate and improve lease tax processes
- Reduce audit exposure and improve compliance
- Offer a simplified, integrated system

Companies are quickly discerning that technology is the cornerstone of their ability to scale quickly, prepare for more rigorous future compliance regulations, and gain competitive advantage.

Leveraging Automation to Improve Efficiency and Manage Non-Standard Rates and Rules Updates

As noted earlier, there are more than 7,000 taxing jurisdictions in the U.S. and anywhere between 300-600 tax rate changes in a given year. This constant state of flux, combined with the complexity of large numbers of non-

standard rates that apply in many jurisdictions, challenges tax departments to simply stay up-to-date with current rates and diverts their resources from more productive strategic activities.

Non-standard rates are based upon factors such as the length of the lease term, the type of the equipment being leased, maximum tax caps, and “grandfathered” conditions that grant exemptions from the new rates. Each of these unique conditions provides another potential point of failure,

Best Practices: Enabling Lease Tax Technology for Increased Accuracy and Speed to Market at SunBridge Capital, Inc.

Founded in 1997, Sunbridge Capital offers funding for trucks, trailers, and construction equipment costing between \$15,000 and \$250,000. SunBridge has a \$350 million portfolio that includes over 7,000 assets. SunBridge writes TRAC, 1st amendment, and Capital leases in all 50 states and has experienced a 600% growth in originations in the past three years.

An innovative company, SunBridge differentiates itself from the competition by focusing on the ease and speed of its lease transactions. Convenience is a significant motivator to businesses looking to quickly add or swap leased vehicles and equipment. SunBridge also realizes that the ease and speed that brands their transactions has to include accuracy as well. To accomplish all of this - reliably and repeatedly - SunBridge adopted the philosophy that it would employ technology wherever possible in its workflow and backend operations. As a result, the company implemented the Vertex® Lease Tax O Series® solution.

SunBridge realized that it could not achieve the transparency it desired without an integrated technology platform. Leasing vehicles and equipment in 50 states through distribution and channel partners while reaching out to a host of financial services companies provided enough variables to juggle. They did not want to tackle difficult systems integration projects as well. SunBridge has implemented a technology solution that takes advantage of SOA and standards to achieve interoperability within and without its vendors’ solutions sets. This approach has helped to drive down SunBridge’s total cost of ownership.

Additionally, just as SunBridge determined it could differentiate itself from the competition by focusing on ease and speed of transactions, they also determined that the path to ease and speed had to include a technology platform that delivered the same.

SunBridge Capital identified the following requirements for its new tax software platform:

- Support a wide breadth of data (50 states, multiple finance partners, variety of tools, and international presence)
- Easy integration with other key systems
- Service and support from tax experts, not just tech experts
- Outsourced solution

SunBridge has a lean internal staff – 6 developers who are not tax experts and 2 tax experts who are not technical experts. Third-party involvement in the implementation was needed to integrate the origination and backend systems.

The end result for SunBridge is a transaction processing timeline that has gone from a few hours to a few minutes. The originations system is able to quote the tax, the sales person understands fully the logic applied, exemptions are clearly documented, and the tax is fully booked online. Integration with accounting is complete and tax returns have been automated. SunBridge’s internal focus on technology has enabled them to quickly mobilize their operations to take full advantage of marketplace trends.

another chance for miscalculation, and either the under- or overpayment of tax.

Applying non-standard rates and rules is a struggle even for companies using lease portfolio systems and tax subscription services. These types of tools typically are not comprehensive or may not even address non-standard tax rates. Non-standard rates vary widely from state-to-state and may also vary by source, classification, and payment schedule. For example, South Carolina imposes a maximum tax of \$300 on both the sale and lease of vehicles while Arkansas applies a different maximum tax to a sale than it does to a lease.

Manual updates of the non-standard rates and rules are a reality for many organizations where the tax department relies on either the use of spreadsheets or sales tax software that includes very little, if any, lease tax logic or rules. The opportunity for error is great. Tax research may lag causing rate and rules changes to not be applied in a timely fashion and new rules may even be incorrectly applied. In these environments, the need for resource allocation for tax research and updating continues to grow as the company expands its customer base to new jurisdictions. Costs rise and there is no guarantee of data quality.

A byproduct of growth for many leasing companies is a significant increase in the number of financial partners. With growth in the number of stakeholders comes an increase in the number of requests for reporting to each of the entities. These entities need to be confident that all of the lease fees are accurately calculated – including the tax applied. Tax departments that rely on manual efforts struggle to meet the deadlines and custom reporting requirements of the multitude of financial services organizations.

The complexity of the tax calculation during the origination phase of the leasing process leads many lessors to implement a centralized, automated tax software solution to update and manage tax rates and rules. The lease tax solution complements the asset management system used by the lessor, and as a result, improves the speed and accuracy of all phases of the lease life cycle: origination, service, and reporting.

By transitioning from manual to automated updates, companies realize a number of efficiencies in addition to gains in accuracy and consistency. Tax software solutions

that utilize the latest service-oriented architecture (SOA) technology and intuitive user interfaces reduce expensive administrative burdens attributable to lengthy new employee training and heavy IT involvement. The technology enables increased transparency and the ability to share data across multiple disparate applications. And when tax rates and rules updates are the responsibility of the software provider rather than the internal tax team, the tax department is able to focus on more strategic efforts such as planning, analysis, and forecasting.

Integrating Financial Applications to Improve Data Accuracy and Ensure Regulatory Compliance

Compliance is essentially data quality and data management: Has my company applied rules and rates correctly? Can I clearly track my business processes? Is my data consistent? Two regulatory programs having a strong impact on the taxation of the U.S. leasing industry are the Streamlined Sales Tax Act (SSTA) and Sarbanes-Oxley (SOX). For companies with an international presence, the list expands to include EuroSOX, International Financial Reporting Standards (IFRS), and Basel II.

The Streamlined Sales Tax Act is intended to improve overall business outcomes. Despite the SSTA's intent to simplify sales tax administration nationwide, state participation remains voluntary and many have not yet signed on. In turn, companies struggle, not from an unwillingness to comply, but rather from the sheer magnitude of work required to stay current on a state-by-state basis with SSTA rules, the amendments granted, and the ongoing changes to other related rates and rules.

For the leasing industry, SSTA presents additional challenges surrounding sourcing rules. The SSTA differentiates between sourcing of leased equipment, motor vehicles, and transportation equipment. To complicate matters further, sourcing can also vary depending upon the specific classification the asset falls into and whether the lease is paid for in a lump sum or in regular installments. There is clearly a great deal that is not yet streamlined about the SSTA.

The Sarbanes-Oxley Act Section 404 introduced another level of complexity and prompted the industry to improve controls and financial reporting. The Act requires that public

companies be completely transparent in their auditing practices, as well as evaluate and disclose the effectiveness of internal controls related to financial reporting.

Adherence is not only the work of public companies. Many small, private organizations elect to adopt some of the best compliance practices implemented by larger, public companies. Often, the smaller companies are able to secure more favorable rates or attract top talent because of their transparent accounting processes.

Combined, the SSTA and SOX place an enormous burden on companies that are not utilizing the latest technologies to help automate regulatory updates, improve internal controls, and streamline auditing processes.

Minimizing audit exposure – whether at the state tax level or with regard to overall compliance of business processes – is a driving principle for most companies and technology is playing a broader role to achieve this goal. An automated, systematic approach is required to elevate the performance of the tax department, maintain compliance, and mitigate risk. The solution lies in simplifying, standardizing, integrating, and automating process elements across all phases of the leasing life cycle to create a data continuum.

The latest advances in lease tax technology are helping to improve data reliability and reduce redundancy through the integration of disparate data sources. System integration creates a single source from which clear, consistent data can be tapped. Immediate access to accurate data and automated rate updates provides leasing companies with greater visibility into their risk exposure and a proactive approach to regulatory compliance. By knocking down application silos and synchronizing data, leasing companies are able to increase the speed at which they respond to the influx of regulatory changes and stakeholder demands.

Enabling Enterprise Services to Streamline Business Processes and Foster Profitable Growth

Similar to new systems being deployed in other industries, the platform for the leasing industry needs to be flexible and scalable. It needs to easily incorporate legislative changes while expanding to include global tax rates and rules. Using SOA the new solutions will marry Enterprise Resource Planning (ERP) systems with asset management systems and in the end, will result in an overall lower cost of

ownership.

Doing things smarter, faster, and more efficiently also means doing things with greater control and for less cost. Aging legacy systems do not offer the power, flexibility, and intuitive user interface necessary for today's tax department. The tasks of updating, reporting, and auditing can become even more complicated when handled over multiple systems and when written in languages that are no longer mainstream. Add to this the human resource costs for the duplicate effort of updates and maintenance, and the result is one of diminishing returns.

Efficient tax processing is best handled through a centralized tax system with a data repository for enterprise use. In this environment, content for all tax types can be supported (such as sales, consumer use, VAT, and others). Centralized, SOA-based systems also provide for easier scalability and they are able to bridge a variety of financial applications and requirements using a single system.

In shifting from legacy systems to a centralized SOA platform, organizations are able to unite their internal departments to identify common needs and define system requirements together. This joint planning enables streamlined workflows that facilitate a reduction in cycle time, improved cross-functional communications and

Example: The Challenge of Maintaining Multiple Legacy Systems

An established, Fortune 500 motor vehicle captive leasing company found itself with more than 13 legacy systems, each storing some form of lease tax rules. Maintaining tax rates, rules, and logic in each of these systems became very difficult. Resources were needed from both the tax and IT departments to keep the information updated. The project was costly and consumed a large amount of internal resources. In the end, the company invested in an IT project to create a tax service module that housed tax rules and fed them out to each of the legacy systems. This allowed the company to realize improved efficiency as manual updates were now made in one place - not 13. However, as non-standard rates and all tax rules still needed to be updated manually they were not able to achieve maximum efficiency.

Conclusion

New asset finance models and commerce channels are continually emerging and with frequent tax rate and rules changes, it is in the best interest of motor vehicle and equipment leasing organizations to embrace the technology standards available for ease of integration and platform expansion. Innovative companies are already structuring their operations to maximize these opportunities as they emerge without relying on additional headcount or external resources. Companies like SunBridge Capital (highlighted on page 3) are demonstrating how to best address leasing industry challenges by employing a technology platform that helps to simplify the cost of compliance, reduce administrative burdens, and manage legislative changes.

Contributors

This paper was developed as an extension of the Vertex hosted Webcast "Surmounting Lease Tax Compliance Challenges: A Customer and Industry Perspective" with featured presenters;

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To access the on-demand replay of this Webcast or for more information on the Vertex® Lease Tax O Series® solution, please visit vertexinc.com.

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