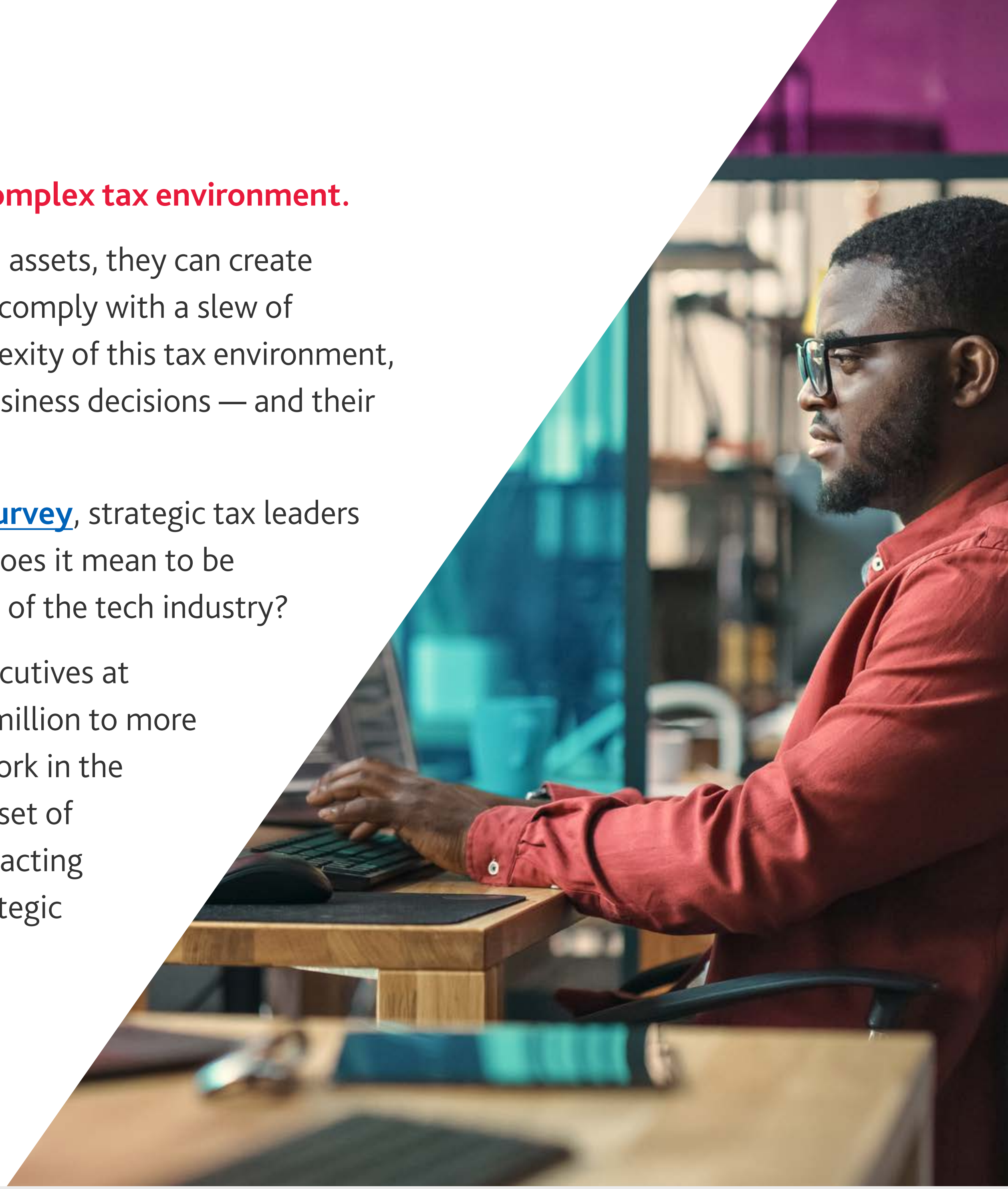
Tech's 2023 Tax Landscape

Technology companies face an especially complex tax environment.

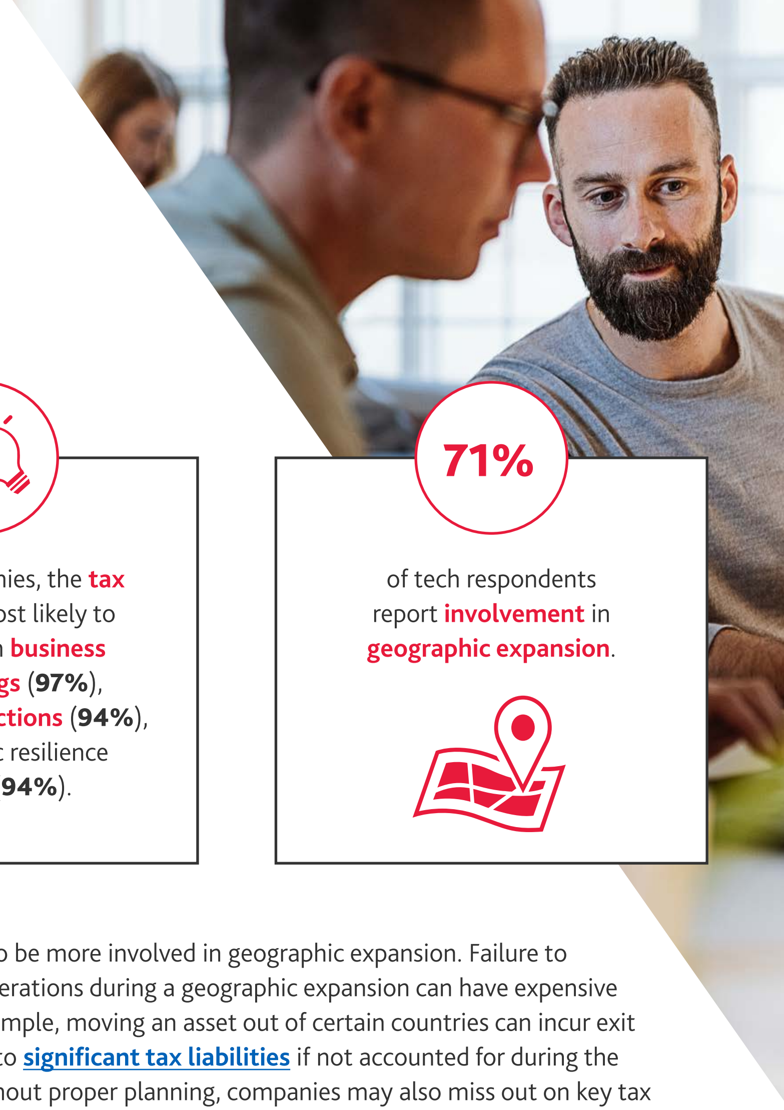
Because tech companies largely sell intangible assets, they can create nexuses in all U.S. states, while also having to comply with a slew of international tax regulations. Given the complexity of this tax environment, tech tax leaders are critical to making good business decisions — and their influence is growing.

According to the **2023 BDO Tax Strategist Survey**, strategic tax leaders drive better business performance. But what does it mean to be a strategic tax leader, especially in the context of the tech industry?

In March 2023, BDO polled 150 senior tax executives at companies with revenues ranging from $250 million to more than $3 billion. Of those 150 executives, 35 work in the tech industry. We analyzed the data from this set of respondents to identify the top tax trends impacting tech companies and their implications for strategic tax leaders.



The Role of Tax Leaders



SURVEY SAYS...

77%

of tech respondents say the **tax function** is regularly invited to weigh in on **business decisions** before they are made, and their **recommendations carry significant** weight.

80%

of tech respondents report **involvement** in **workforce strategy**.

At tech companies, the **tax function** is most likely to be involved in **business restructurings** (**97%**), M&A and **transactions** (**94%**), and economic resilience **strategy** (**94%**).

71%

of tech respondents report **involvement** in **geographic expansion**.

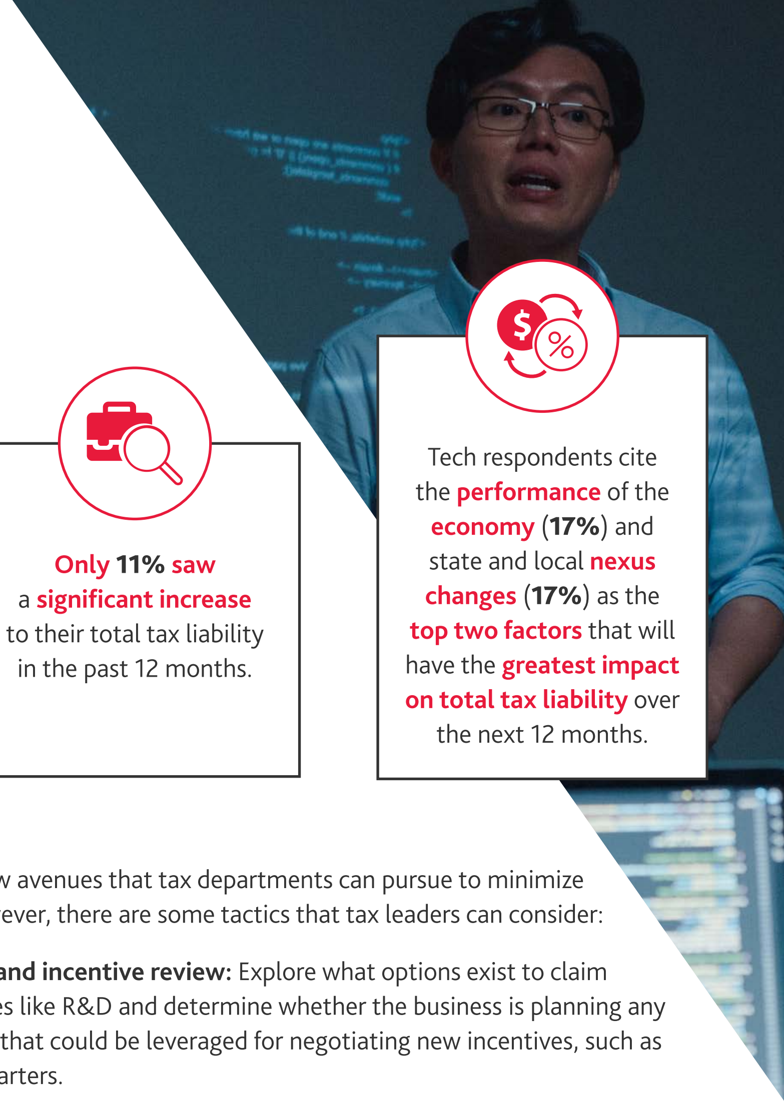
Within tech organizations, tax leaders are seen as critical to business strategy, with most respondents reporting they are regularly consulted on business decisions. Unsurprisingly, tax leaders are most likely to be involved in areas with clear financial implications, like restructurings and deals. Tax leaders are consulted less often in areas like workforce and geographic expansion.

Human resources and payroll often neglect to include tax leaders when they're making key decisions like hiring employees or selecting a professional employer organization (PEO) to support the payroll function. These decisions can have tax consequences that are often uncovered too late. For example, remote workers can carry tax implications based on the state in which they live, which should be considered as part of the hiring process. The tax department can play a key role in reducing tax liability by ensuring workforce decisions are tax advantageous.

Tax leaders should also be more involved in geographic expansion. Failure to account for tax considerations during a geographic expansion can have expensive consequences. For example, moving an asset out of certain countries can incur exit taxes, which can lead to significant tax liabilities if not accounted for during the planning process. Without proper planning, companies may also miss out on key tax savings in the form of federal, state, and local incentives.

If tax leaders aren't already invited to the table for these key decisions, they should proactively seek involvement to ensure that the organization makes choices that align with its overall tax goals. For tech companies specifically, the tax department should seek involvement in partner agreements, such as those with independent contractors and referral networks, which can be structured to be tax advantageous. By ensuring their experience is accessible during major business decisions, tax leaders can mitigate tax risk, identify new opportunities, and optimize total tax liability.

Total Tax Liability Is Increasing



SURVEY SAYS...

60%

of tech respondents say their **total tax liability** will **increase** in the next **12 months**.

40%

saw total tax liability **increases** in the last **12 months**.

20%

expect the **increase** in their total tax liability to be **significant**.

Only 11% saw a **significant increase** to their total tax liability in the past 12 months.

Tech respondents cite the **performance** of the **economy** (**17%**) and state and local **nexus changes** (**17%**) as the **top two factors** that will have the **greatest impact on total tax liability** over the next 12 months.

Tech companies are finally starting to recover from the economic volatility of the last 12 months. Profitability is increasing, and this growth is reflected in shifting expectations around total tax liability. As a company generates greater profits, its total tax liability increases.

In understanding total tax liability, state tax is a critical factor. Due to the South Dakota v. Wayfair decision, tech companies must claim nexus in every state where they make a sale, not just the states in which they have operations. Given that most tech companies sell intangible assets, they could conceivably have nexuses in every U.S. state, which can significantly increase total tax liability.

At the same time, many states are making regulatory changes that will increase total tax liability for all companies, even beyond those in the tech industry. For example, many states are moving from separate filing to combined filing, which restricts options for intercompany planning. State apportionment methodology is also continuing to move to market-based sourcing, which has the overall effect of apportioning more income to the states.

There are relatively few avenues that tax departments can pursue to minimize total tax liability. However, there are some tactics that tax leaders can consider:

- **Conduct a credit and incentive review:** Explore what options exist to claim statutory incentives like R&D and determine whether the business is planning any business decisions that could be leveraged for negotiating new incentives, such as expanding headquarters.
- **Move operations:** Many tech companies aren't fixed-asset intensive, which can make moving operations more accessible than for other companies. Moving operations is a major decision that requires companies to evaluate all potential factors, such as the availability of labor in the suggested location, but it may be worth considering if there are significant tax advantages.
- **Take advantage of pass-through entity tax:** Taking advantage of pass-through entity tax (to the extent that companies are not C-corps) allows companies to avoid the federal cap on deductible taxes at the individual level.

Tax Workforce Challenges

SURVEY SAYS...

26%

of tech respondents say their **top priority** in the next 12 months is **recruiting** and **retaining** the right **tech talent**.

When asked about their **primary goal** for their tax department in the next 12 months, **23%** of tech respondents say **achieving the right tax staffing model** for the department.

20%

of tech respondents cite **lack of candidates** with **specialized knowledge** as their **top challenge** to attracting and retaining talent.

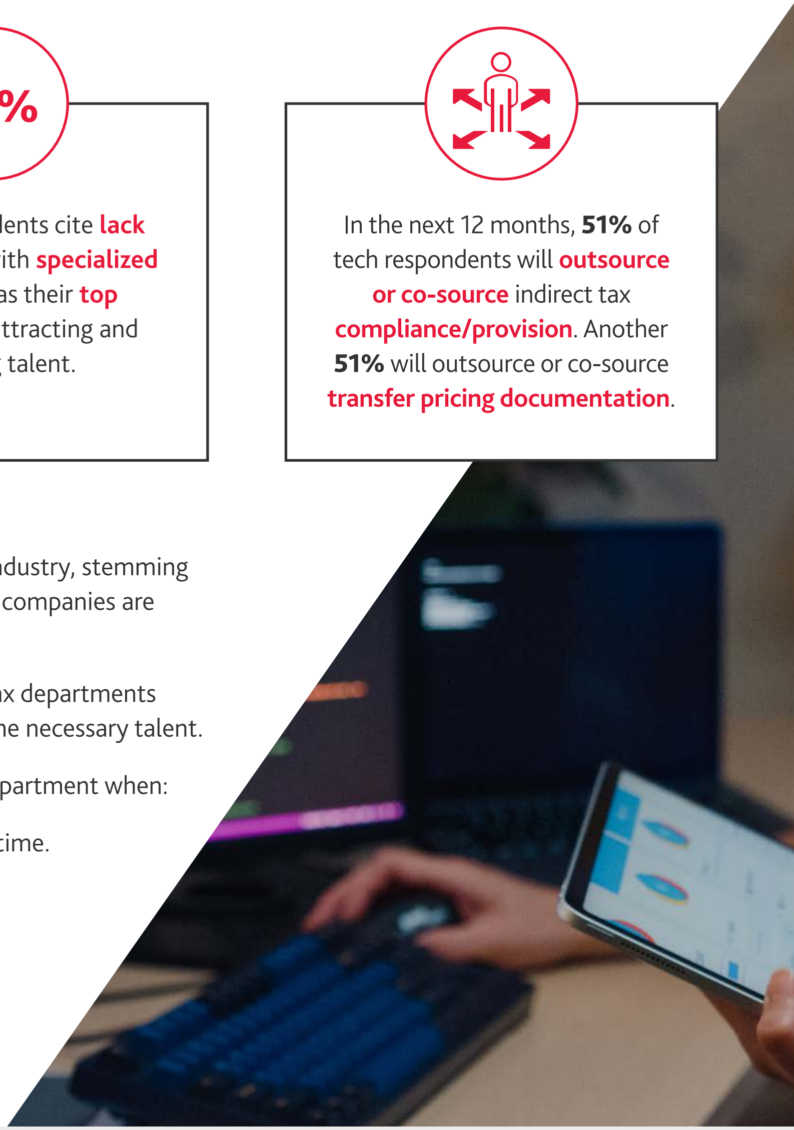
In the next 12 months, **51%** of tech respondents will **outsource or co-source** indirect tax **compliance/provision**. Another **51%** will outsource or co-source **transfer pricing documentation**.

The past year has been volatile for the tech labor market, with several unexpected high-profile layoffs impacting the industry, stemming from unfavorable economic conditions and higher interest rates. Now that the economy is beginning to stabilize, tech companies are revisiting their staffing models.

For tech tax departments, the challenge is even greater: different tax functions require specialized knowledge, which tax departments struggle to attract even in the best of times. After the tech industry shakeup, it may be even more difficult to attract the necessary talent.

Outsourcing or co-souring are key strategies for achieving the right tax staffing model and can help support the tax department when:

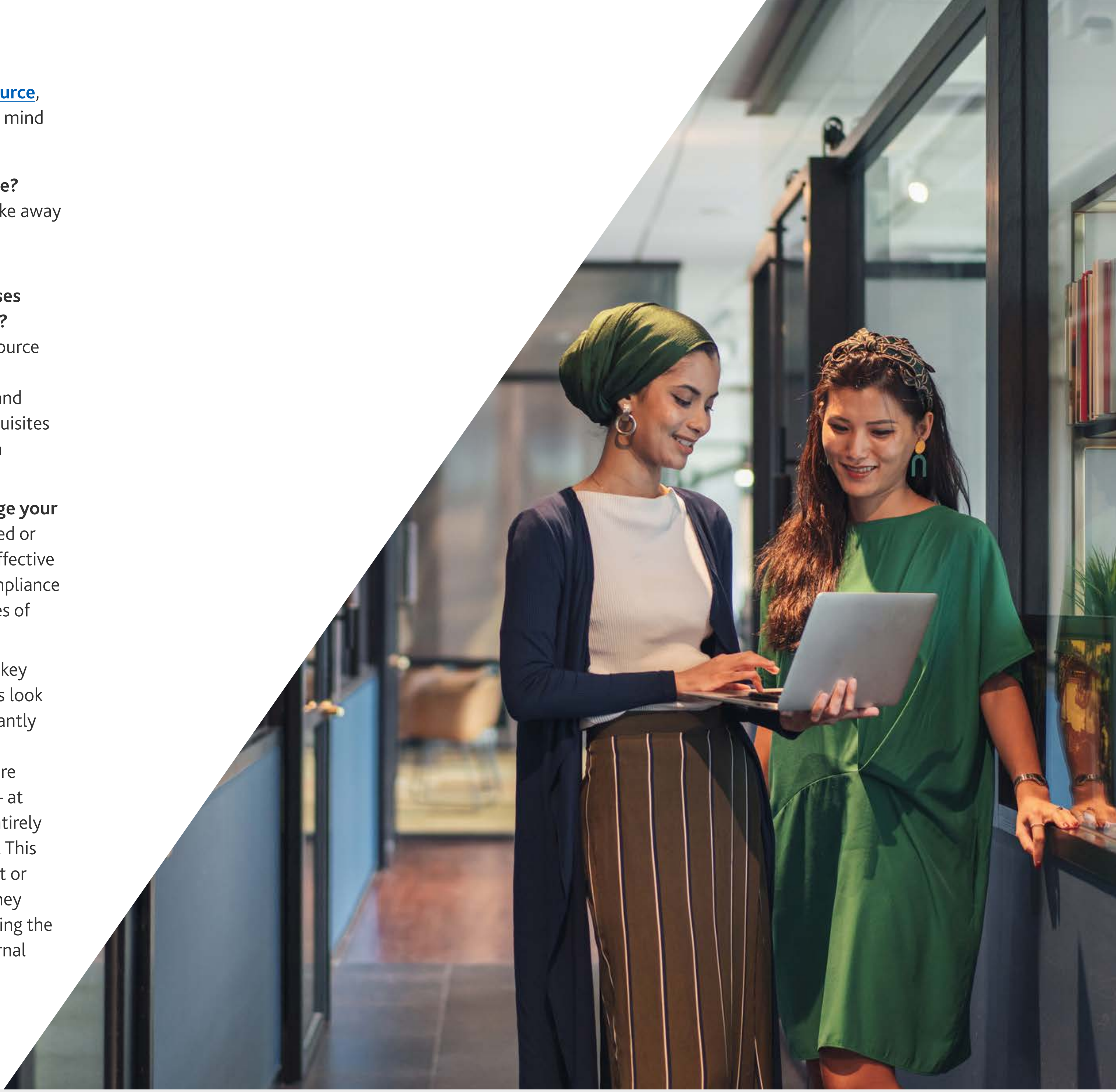
- **Specialized tax knowledge** is required on an inconsistent basis, making it too expensive to keep someone on full-time.
- The department is **implementing or integrating a new tax system** and needs additional expertise and support.
- **Resource constraints** make it difficult or impossible to hire additional full-time employees.
- The department is contending with **business restructuring and integration** on top of the usual compliance and reporting requirements.



When determining **where to outsource or co-source**, there are a few considerations you should keep in mind to improve your chances of success:

- **What work is repetitive and/or high-volume?** Look specifically for work you would like to take away from your high performers so they can focus on strategic priorities.
- **What types of projects have strong processes and information-sharing resources in place?** These projects are easier to outsource or co-source than projects that are disorganized or highly complicated. Look for areas where accessing and significantly manipulating data are not prerequisites to an outside services firm's level of success in supplementing the tax function.
- **What projects require specialized knowledge your team does not currently have?** An outsourced or co-sourced specialist may be the most cost-effective way to complete these projects. Sales tax compliance and income tax compliance are great examples of specialized areas that can be outsourced.

Outsourcing and co-sourcing are likely to remain key strategies throughout the year, as tech companies look to maintain and grow operations without significantly increasing their costs. However, it's important to keep in mind that you cannot outsource your entire tax function. You must have someone in-house — at least at the director or manager level — who is entirely dedicated to minding the tax side of the business. This person can work either from a strategy standpoint or from a notice-response standpoint. Regardless, they must be accountable to the organization for keeping the tax function running effectively and keeping external resources informed and accountable.



Tech's Approach to Tax Technology

SURVEY SAYS...

26%

of tech respondents say that their **top challenge** in the next 12 months is **using new technology**, tools, and techniques, making it their top-cited challenge.

26%

of tech respondents say their **most significant priority** for the tax department in the next 12 months is **integrating existing technologies** already licensed.

51%

of tech tax leaders have **already deployed artificial intelligence**/machine learning, and **31% plan to deploy** it in the **next 12 months**.

Tax leaders are looking to take advantage of technology to augment their department — and for good reason. Advancements in technology are making it possible to automate repetitive tasks so tax professionals can spend more time on high-value work that requires human judgment.

However, adopting and enhancing tax technology can be a difficult and disruptive process, particularly if new technology is not implemented correctly. When it comes to selecting and deploying tax technology, it's crucial to work with the right vendor and the right implementation organization. Some vendors may be great at developing software but struggle with the implementation or integration process required to adapt the software for a company with an existing IT architecture and changing business requirements. Tech vendors may lack the right tax expertise to address questions and anticipate regulatory challenges, particularly regarding a complex or changing business structure. You need to ensure you're working with an entity that has the tax knowledge and technology, process, and project management skills to be able to answer your unique questions and manage the implementation process.

One recent technological innovation in particular offers new opportunities for tax leaders: generative AI. Generative AI can analyze large amounts of data in disparate formats, which can free up significant time and resources in the tax department. For example, generative AI can support:

- Tax risk management (ex. Identifying errors, non-compliance, or fraud)
- Tax planning and analytics (ex. Identifying patterns and trends or highlighting opportunities for savings)
- Process improvements (ex. Reducing repetitive tasks like data entry or standardization)

However, while generative AI can bring significant benefits to the tax function, it also carries serious risk, including:

- **The possibility of "hallucinations,"** which can result in the platform generating incorrect answers or answers not supported by its training data.
- **The potential for a privacy breach,** especially for open-source platforms, which can put organizational data at risk.

Before adopting generative AI, tax leaders need to carefully consider and take proactive steps to mitigate risk factors. In particular, tax leaders should take the following steps:

- Obtain an understanding of the company's data structure and sources in order to identify any potential limitations that may impact the AI functions you want to deploy.
- Ensure a human tax professional is always kept in the loop to review all findings and confirm the generative AI model is working as intended.
- Schedule training sessions to ensure all employees are using the platform correctly.
- Screen for generative AI skillsets when making hiring decisions.
- Avoid using open-source platforms and instead select platforms that prioritize data protection; for example, platforms that do not keep and use their data for training purposes.

The Tax Department's Role in ESG Strategy

SURVEY SAYS…

37%

of tech respondents say their organization has **minimal** to almost **no understanding** of **how tax intersects** with its **ESG strategies**.

94%

say their tax department has a **formalized mandate** in **advancing** their organization's **ESG strategies**.

37%

say their tax department has a **formalized mandate** in **advancing** their organization's **ESG strategies**, but they are **not executing** against it **effectively**.

51%

of tech respondents say their tax department has made **quantitative disclosures** such as total tax contribution or country-by-country reporting.

26%

say their **greatest challenge** to **ESG**-related tax transparency reporting is **data collection** and **analysis**.

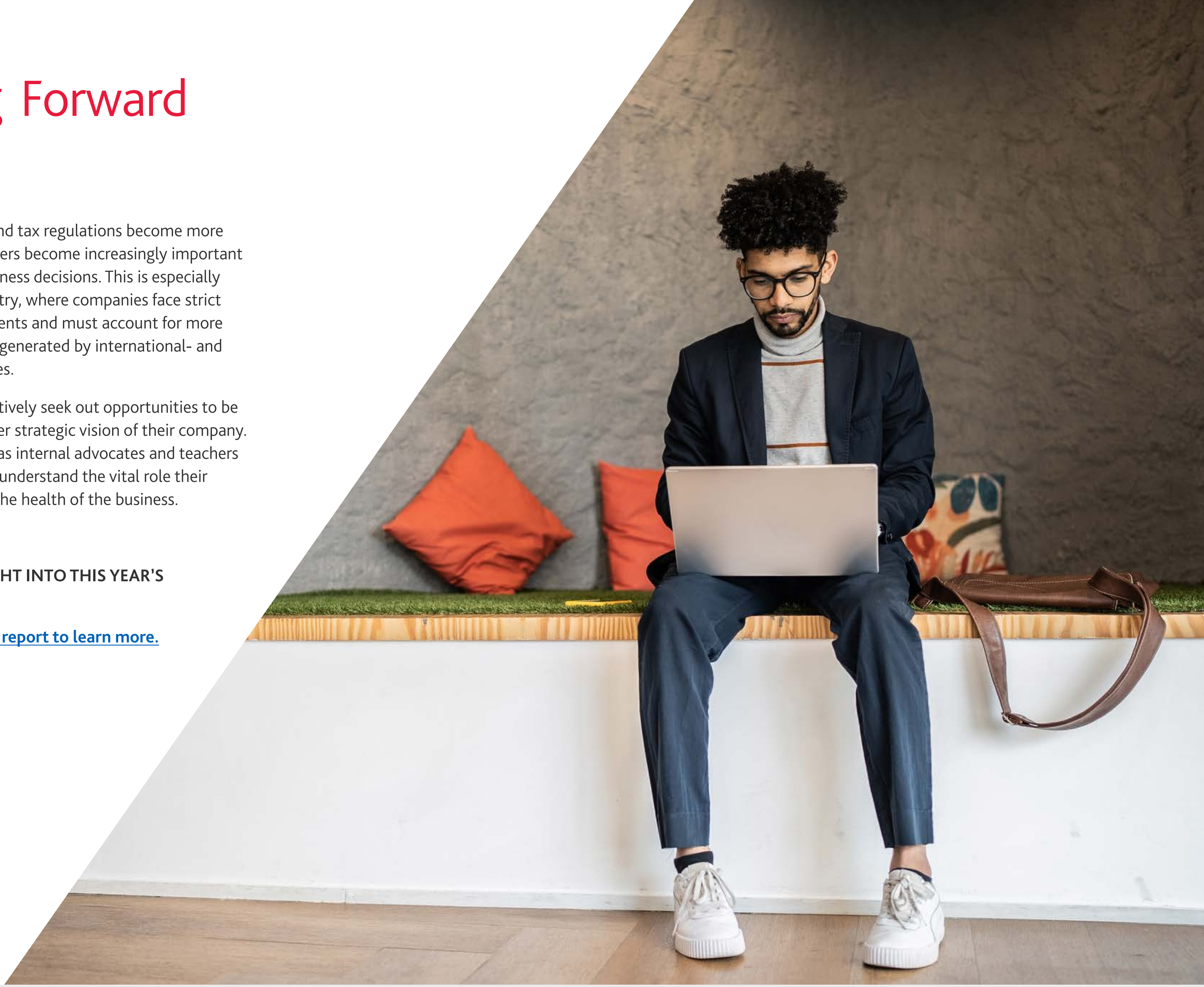
While most business leaders see the value of involving their tax department in their ESG strategies, a significant number need more education on how their tax department can effectively inform and support those strategies. As one example, business leaders may not understand how or why their business can claim tax credits and incentives for the ESG initiatives they are pursuing or the role of tax in ESG-related reporting requirements. They may simply lack the tax-specific knowledge necessary to make those connections; tax leaders may need to educate other executives on how tax relates to ESG strategy.

When it comes to ESG reporting, tax departments at tech organizations still have a long way to go — especially as global regulators intensify their scrutiny. For example, there is a growing demand for tax transparency, which requires organizations to measure and report on their total tax contribution. For this type of reporting, data collection and analysis remain a significant roadblock. Without access to the right data, it's impossible to accurately report on or fully understand an organization's progress against its ESG commitments.

To enable accurate ESG reporting, tax leaders should consider the following actions:

- Review the company's existing data and data collection controls and processes to ensure it has the appropriate, accurate, and sufficient information to substantiate its reporting.
- Study the company's data management and governance processes and standards to identify and address gaps that could hinder compliance with reporting requirements.
- Consolidate disparate systems, which may result from M&A deals and expansions where tax was not prioritized in the planning process, to ensure all data is centralized, accurate, and accessible.

Moving Forward



As businesses grow and tax regulations become more complicated, tax leaders become increasingly important to making sound business decisions. This is especially true in the tech industry, where companies face strict compliance requirements and must account for more changing regulations generated by international- and state-level tax changes.

Tax leaders should actively seek out opportunities to be involved in the broader strategic vision of their company. They should also act as internal advocates and teachers to help other leaders understand the vital role their department plays in the health of the business.

WANT MORE INSIGHT INTO THIS YEAR'S TOP TAX TRENDS?

[Read our full survey report to learn more.]

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