What Is Total Tax Liability…

and What Does It Mean for Your Business?

Contents

Businesses today are more connected than ever before, but that doesn't mean things are getting simpler. In fact, it's just the opposite. From naturally increasing globalization, exacerbated by domestic political agendas, to the rise of disruptive technologies, business complexity is rapidly accelerating and many businesses are struggling to keep up with the pace of change.

As global business becomes increasingly complex, taxation of businesses has also become more complicated. Governments and other tax authorities are intensifying their scrutiny on corporate tax practices, increasingly working together and pushing for transparency mandates — like the Organization of Economic Cooperation and Development's two-pillar framework to address Base Erosion and Profit Shifting (BEPS) — to tighten regulations and close outstanding loopholes.

And they're not the only ones taking notice of tax practices. Investors, watchdogs, the media and even the public have become increasingly concerned about companies paying their "fair share."

The spotlight on the corporate tax function has never been more intense.

All of this is taking place amid significant and continual change. This includes unprecedented updates to tax laws and regulation, like those originating from tax reform legislation known as the **2017 Tax Cuts and Jobs Act** in the U.S., which altered everything from corporate tax rates to rules around deductions for interest expenses. The **Supreme Court's decision in *South Dakota v. Wayfair*** also sent states scrambling to alter how they tax products and services purchased by customers from sellers operating within completely different tax jurisdictions.

The upheaval isn't just within our borders: Geopolitical tensions are adding to the complexity as well. Trade tensions have escalated more in the past several years than they have in decades, and there's no clear end in sight.

All this means that businesses are now having to consistently examine and update their operational strategies and, for best-in-class organizations, their tax strategies as well. Tax professionals who understand the massive web of changing laws, as well as the economic forces that interplay with them, will be well-positioned to guide their companies through the maze of uncertainty.

Tax Professionals as Strategic Advisors

In the face of constant change and growing economic uncertainty, tax professionals are tasked with acting not just as a critical business function, but also as strategic advisors, and they're being asked to make this crucial shift with fewer resources, leaving them with the fundamental challenge of doing more with less. The demands are high, and so are the stakes: Any misstep could result in damages to profits and reputations. Navigating high-stakes challenges with limited resources, all while keeping up with the rapid pace of change, is now the name of the game.

To put it bluntly, tax professionals are facing pressure from all sides.

But along with these challenges comes the opportunity for businesses to alter how they look at their own tax strategies. And many are open to embracing this change.

For tax professionals to navigate unsteady waters ahead, they need to take a **total tax mindset, which requires understanding their total tax liability**.

What Is Total Tax Liability?

Total tax liability is both calculation and concept: At the most basic level, it is the sum of all taxes owed at a given point in time, factoring in income, indirect, property, payroll, excise and other taxes, as well as customs and duties, and then the credits, incentives and deductions at the international, federal, state and local levels.

This might sound like a relatively simple concept, but the reality is that most businesses focus on income tax above all others. There's good reason for this: Often income taxes make up the largest single tax cost for companies, and it's certainly the most scrutinized by the media and the public (consider all the headlines you've seen about tech giants paying no income taxes). Generally Accepted Accounting Principles (GAAP) reporting requirements only call out income tax specifically, so it's often unclear what other taxes a company may be paying.

But income taxes alone are never the full story.

A business may pay relatively low income taxes, instead generating the largest amount of tax liability from other taxes. It's also not a one-time calculation — instead, it's constantly shifting from day to day, and even from minute to minute. For example, an operational strategy that minimizes income tax and maximizes operational cost efficiency may create significant duty or tariff exposure, more than offsetting income tax success when trade dynamics change around the world.

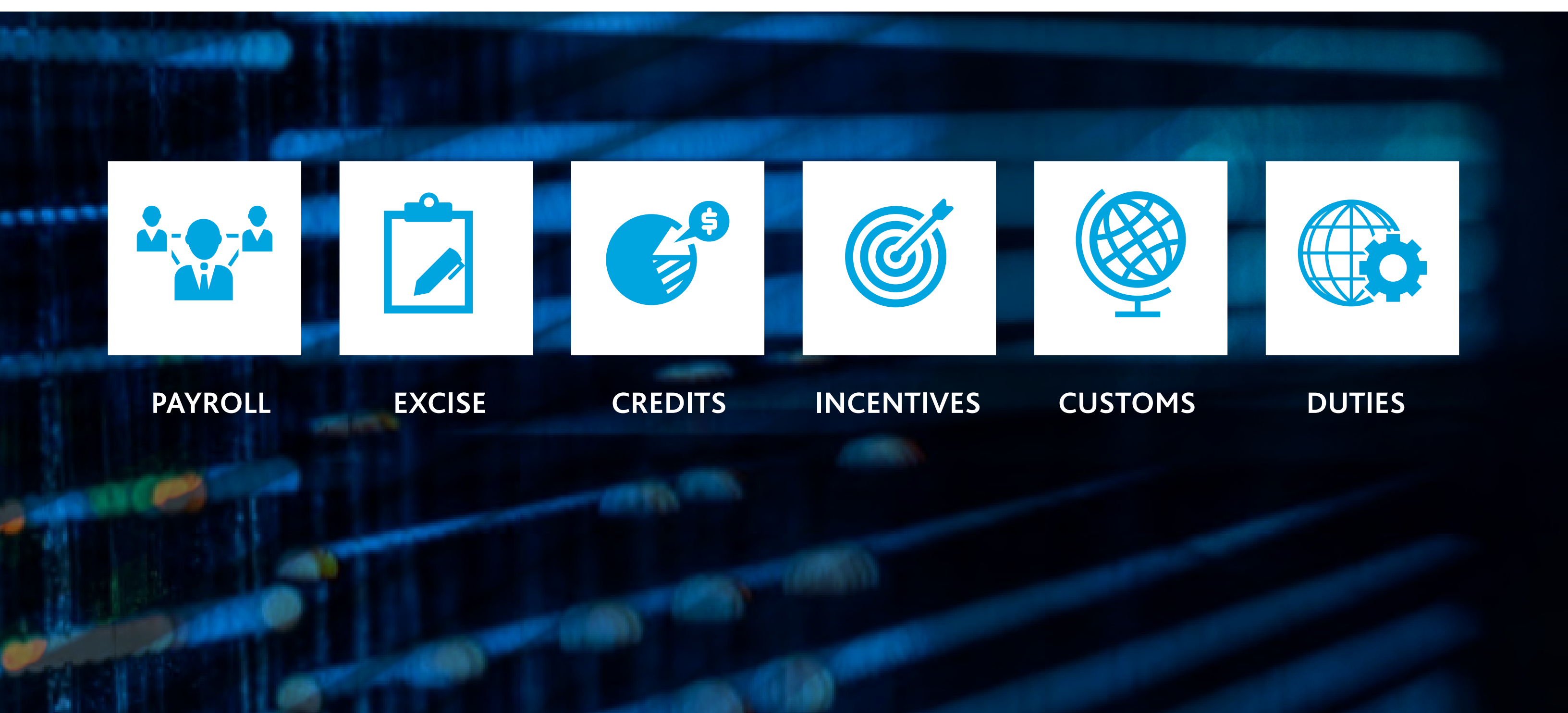
And total tax liability is more than just a number. It's a holistic approach to tax strategy.

Consider the concept of the "butterfly effect," in which a seemingly minor action or change within a system can generate large impacts in other areas of the system. This concept holds true for tax and is at the crux of the total tax mindset. All business decisions, legislative changes and external forces can cause shifts in an organization's total tax liability.

For example, a company decides it wants to open a new location in a new state to capture an untapped market for its services or products. On the surface, this might seem like a smart move that could increase revenues, but it will actually activate a host of tax implications from property to payroll. There could also be local credits or incentives to help offset costs. If those factors aren't considered at the outset, a company could find itself unaware or unprepared to address its new total tax liability.

This ripple effect extends beyond the tax department. A company's total tax liability is not a static number. Each and every business decision has tax consequences, and for leaders to truly understand the impact of their choices, it's critical that they keep a pulse on their total tax liability calculation.

Tax professionals need to ensure they're highlighting how strategic business decisions impact a company's total tax footprint and should encourage a business culture where mapping the tax implications is factored into decision making, rather than considered as an afterthought.



Benefits of a Total Tax Mindset

While failing to put total tax posture at the forefront of tax and business strategies can lead to significant costs and risks, managing it effectively provides businesses with a leg up on navigating today's challenges.

Modeling the total tax impact of future operational decisions allows tax professionals to assess the ripple effect of various business decisions, such as supply chain shifts, implementing ESG strategies, pursuing M&A or adjusting workforce strategies. If tax departments are collaborating more often, they can eliminate potential risks, increase efficiencies and find new strategies that turn the department into not just a risk-mitigation tool, but also an actual revenue driver that adds significant savings to the company's bottom line.

Understanding total tax liability also means companies are better able to communicate with the vast number of stakeholders they face. Mapping out all the tax dynamics makes it far easier to provide detailed information to governments and regulators when requested. There's also good reason to think that the push for tax transparency isn't going away and taking a total tax mindset will enable companies to answer the call for greater transparency. It also equips a company to more effectively tell its own story to the public, investors, board members or shareholders, explaining how business and tax strategies work in tandem to increase savings and drive profits.

The Perils of Tax Myopia

Tax departments that fail to focus on total taxes might be unable to maintain an effective tax mitigation strategy and may risk being unable to navigate the increased demands placed on tax professionals, resulting in a number of potential issues.

First and foremost, a lack of visibility into the full spectrum of tax dynamics can result in financial reporting inaccuracies and subsequent compliance issues. According to **Audit Analytics**, tax issues are frequently the cause of public company adjustments and restatements, which can both negatively impact financial reporting and result in costly consequences.

Tax professionals can often be forced to operate in a silo — either due to company structure or other factors — not only from the broader business but also within the confines of the tax department itself. It's entirely plausible that a property tax director in the U.S. may not know what their counterpart is doing about Value Added Taxes (VAT) abroad, nor how their strategies contribute to the overall liability of the company. While these areas of tax might seem disparate, this communication lapse could result in tax inefficiencies. Without the full picture, companies may also struggle to act quickly when changes like new tax legislation come down the pike.

Failing to take a total tax approach may also mean that tax mitigation strategies have unintended consequences. Often, companies that successfully reduce a particular tax, like U.S. federal income tax, accidently end up generating or increasing another tax (e.g., foreign income tax or indirect taxes), eliminating some, if not all of the benefit.

Any tax mitigation undertaken outside a total tax liability process has a high likelihood of adding less value or generating unseen risks than mitigation done with total tax posture at the forefront.

For tax professionals to maximize their roles as strategic counselors, identifying, communicating and optimizing total taxes is crucial. They also must be able to do so quickly and efficiently, ideally in close to real time, to help assess the impact of potential business decisions and forecast the results of future economic scenarios.

The concept of total tax liability is no longer confined to the tax department. Our annual **Tax Outlook Survey** has found a growing understanding among company boards, with almost all board directors having a “moderate” to “high” level of understanding. However, most businesses still have a way to go. While survey findings show collaboration among tax and business leaders is improving, tax is still frequently left out of strategic planning and decision making.

While collaboration among tax and business leaders has improved, tax is still often left out of strategic business decisions.

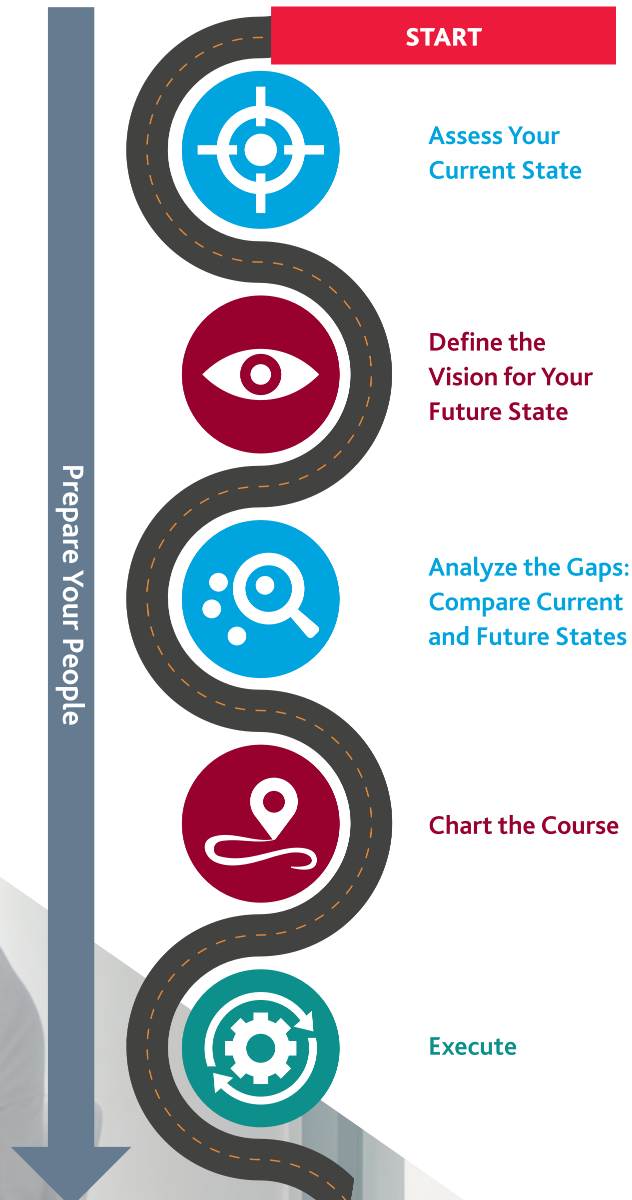
So, how can businesses move forward with a total tax approach? Comprehensive tax strategies require a three-step process:

Identify | **Communicate** | **Optimize**

IDENTIFY

While answering the question *"How much tax does my company pay?"* might seem relatively simple, the culture of most tax departments often makes doing so rather complex. Most tax professionals are siloed from each other and the broader business, and they leverage non-collaborative and antiquated technologies without real-time monitoring capabilities. And the level of tax complexity is not contingent on company size — a middle-market company may experience just as many tax dynamics as larger counterparts, often without the same level of resources to address them.

Follow this process to calculate the current total tax liability for your business:



1. Assess Your Current State

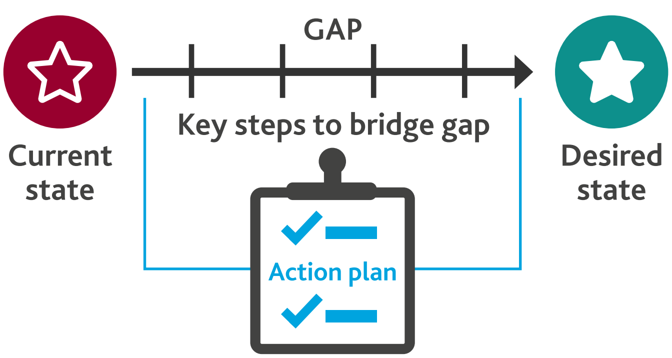
To effectively calculate your organization's total tax liability, you need to gain an understanding of the breadth of tax dynamics you'll need to factor into your total tax liability calculation. Start by reviewing current and historical tax filings and financial reports, as well as speaking with professionals across all areas of the business, both within tax and beyond.

2. Define the Vision for Your Future State

Make sure your organization has crystalized its biggest tax goals. Beyond the obvious goal of truly understanding your total tax liability and, eventually, optimizing it to lower your effective tax rate, companies may have many other reasons to go through this process. Are you trying to better understand the tax implications of business decisions, communicate your financial story to stakeholders, or ensure you're correctly interpreting the impact of new legislation? These goals may shift over time, but having a clear sense of where you're headed will help guide you through any bumps in the road and highlight what capabilities you need to focus on developing.

3. Analyze the Gaps: Compare Current and Future States

Once you've mapped out your current state and desired future state, identify where the gaps exist between them across four levels: technology, people, data and processes. There may be significant gaps in data collection and management, internal communication practices and how tax fits into the typical strategy and decision-making process.

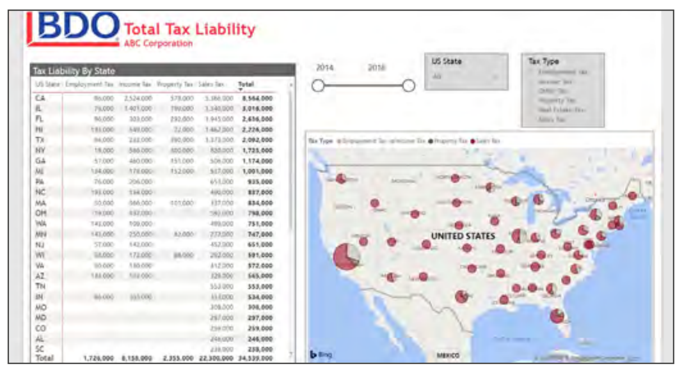


4. Chart the Course

For each gap, lay out a plan of action to close the distance between the current and future states. To calculate total tax liability effectively, you'll need to identify all the inputs that contribute to a holistic picture of your tax posture across the entirety of the organization. Be sure to cover all areas of tax and all jurisdictions, including international, federal, state and local. You'll also need to determine where the data for all of these areas is housed and in what systems.

5. Execute

Synthesize the data you mapped out in step 4. This may involve undergoing a tax transformation process. Use data to determine the current overall liability for each discrete tax area and how it may interact and overlap with other tax areas. Look at all these areas of tax combined to determine total tax liability and its components. Ultimately, you should end up with a holistic picture of your company's tax dynamics at every level. This snapshot of your total tax liability will serve as your initial benchmarking. As you continually recalculate your total tax liability, you can track the impact of, and on, future decisions and strategies.



SPOTLIGHT ON:

Transforming the Tax Function

The agility with which an organization can measure and optimize total tax liability is directly correlated to the sophistication of its tax function. The total tax liability metric is only as good as it is current. Ideally, once the baseline calculation has been established, the methodology becomes repeatable and, ultimately, automated. The road to automation and real-time insight starts with transforming your tax department – fully integrating processes, people, technology and data to understand total tax liability and forecast how decisions and changes will impact tax standing.

What does tax data management and information sharing look like internally, with vendors, and with regulators?

What technology do you need to unlock insights and create value?

What processes are inefficient or the most prone to errors?

Is your entire tax department on board with transformation and educated appropriately? Are broader business leaders aligned with your goals?

Leveraging automation eliminates the manual work and analysis that goes into determining total tax liability, and it empowers the quick and accurate understanding necessary for a modern global company. Rather than requesting and manually combining multiple excel spreadsheets every time you want to update your total tax liability calculation, information from disparate tax and financial information datasets can be automatically integrated and synchronized.

Companies that invest in tax transformation can drive cost savings that can help sustain an organization through challenging times.

BDO's Tax Transformation Guide outlines how companies can transform their tax practice to navigate the increasingly complicated web of tax laws and regulations, enhance the tax department's adaptability and help gain insights to inform and drive business strategy. No two businesses will have the same tax transformation journey. This guide lays out key steps to develop and begin to execute a comprehensive strategy that balances the long-term vision with realistic short-term achievements. Whether addressing direct tax reporting requirements or indirect tax compliance, the decision to make incremental improvements is an important first step in the transformation journey.

Ready to start optimizing your tax function? Request a free Tax Process Assessment.

COMMUNICATE

Now that you've determined your total tax liability, you'll need to communicate it effectively to all relevant parties across your business and beyond.

It's crucial that all the tax professionals operating within your business understand the total tax liability concept and its origins. As the front lines of your tax strategy, they all need to embrace a total tax mindset in order to maximize its potential. Tax professionals can also help explain and contextualize your total tax posture to other key stakeholders who may lack technical tax knowledge, like the C-Suite, board members, or even regulators. Communicating total tax approach to key company leaders positions tax professionals as business strategists, rather than intermediaries. Eventually, the total tax mindset should be an integral part of your company's culture, its business strategy, and its decision-making processes.

Total tax liability is a complex concept, and explaining it effectively to stakeholders typically requires more than just static spreadsheets. Dashboards consolidate and arrange data, key performance indicators, or KPIs, and often performance scorecards on a graphical interface, making them useful tools in communicating total tax liability to both tax professionals and non-tax professionals alike. They are able to display where individual tax liabilities originate, how they interact and how they ultimately comprise your total liability.

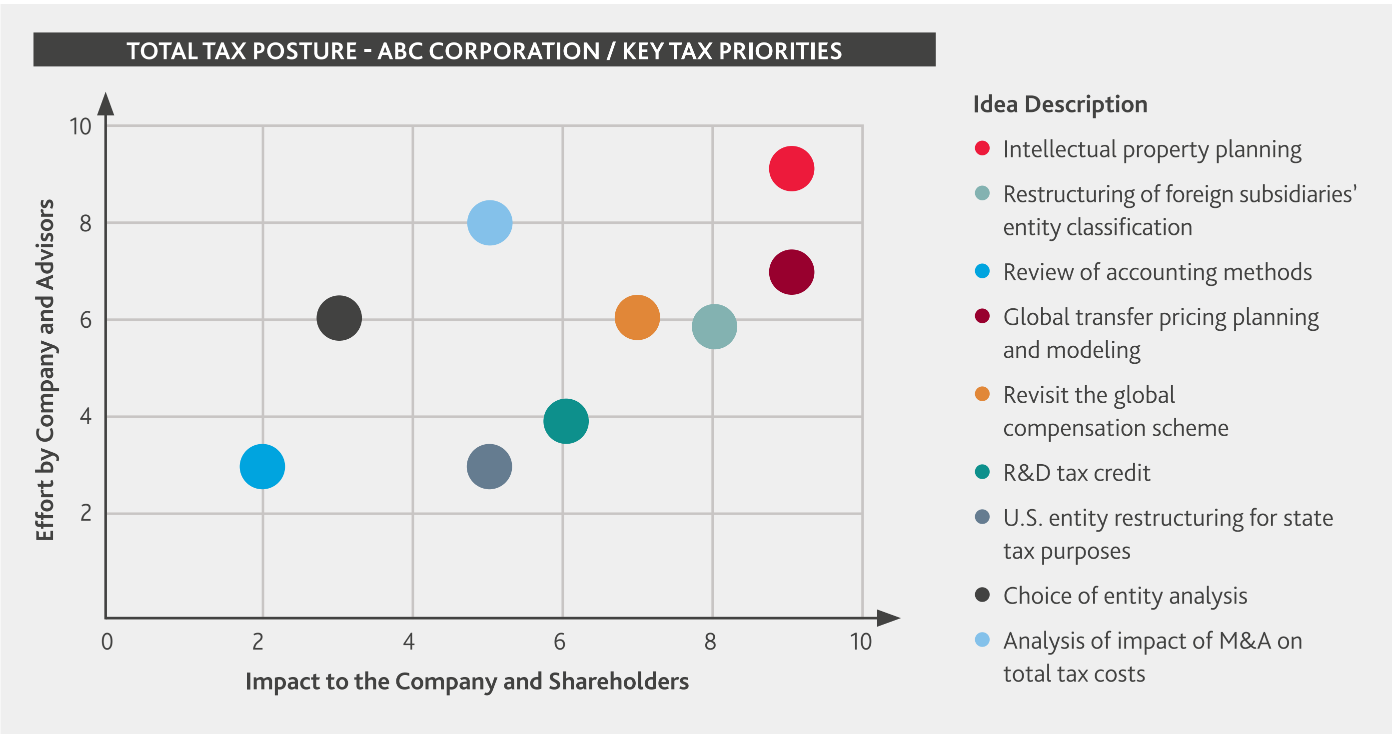
While dashboards can be effective tools for succinctly communicating total tax liability, tools are only as good as the hands operating them. It's critical that as you make the shift to a holistic tax mindset, you work with professionals both internally and externally who are able to keep this mindset at the forefront of tax strategy.

You'll need to work with people who can understand, manipulate and interpret data, and also explain its significance to a variety of audiences. Often this is dependent on company culture and tone at the top, and a commitment to the total tax approach at every level of the business.

OPTIMIZE

Once you've calculated your total tax liability and socialized it across the organization, you can optimize it — with the ultimate goal of lowering your overall tax costs.

After you've assessed every area of taxation, look for where large, or even previously hidden, liabilities lie, and seek to address them. This can be done through a variety of tactics depending on where your target liabilities originate, such as undergoing an R&D credit study to uncover unrealized savings, altering your value chain to lower customs and duties, or even reviewing your choice of entity.



A company's total tax liability calculation isn't a "one and done" process — it should be reassessed on an ongoing basis to continue to mitigate costs, particularly in light of any tax changes or when considering any major business decisions.

Depending on the level of technological integration and sophistication, your company may be able to develop the capabilities to assess your total tax liability in close to real time, providing stakeholders with the most up-to-date tax information available and generating consistent reports to inform regular strategy discussions. You may also be able to leverage predictive analytics, which can approximate the impact of business decisions, legal changes or regulatory shifts on the overall tax liability of the business.

All these capabilities will enable smarter decision making. If, for example, you're considering moving a facility, the potential tax implications are wide-reaching and include property and income taxes, value-added taxes, shipping issues, and other tax considerations. Under a total tax mindset, all of these should be integrated and examined during the decision-making process.

Case study

HELPING A MULTINATIONAL MANUFACTURER ACHIEVE VAT SAVINGS IN EUROPE

Client Industry
Manufacturing & Distribution

Challenge
VAT in Europe was contributing significantly to a company's overall tax liability. However, because they did not take a holistic total tax approach, tax leaders were unaware of how much VAT was costing them, and how they may have been able to lower those costs.

Solution
BDO was able to examine all of their tax dynamics. Through the calculation process, these significant VAT costs were brought to light. Then, when building a new facility in a European jurisdiction, the company was able to identify planning opportunities in the design phase that significantly lowered their VAT costs. Had they not taken a total tax approach, they would've completely missed this significant savings opportunity.

Impact
Total cost savings to date are above half a million dollars. In addition, taking a total tax approach led to increased communication both within the tax department and to other areas of the business, which will likely generate additional savings in the future.

Contact us to see how a total tax approach can identify opportunities across your total tax footprint.

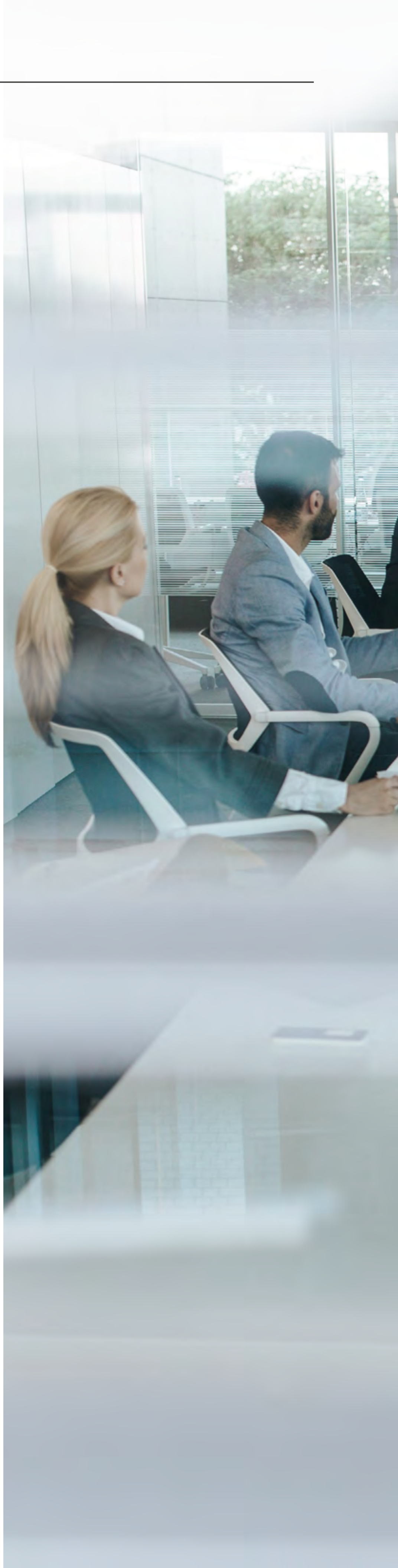
What's Next

Thanks to technology and globalization, today's businesses have more opportunities than ever. But alongside these opportunities, the tax function has grown increasingly complex, and too often is considered an afterthought when it comes to strategic decision making.

We believe taxation has always represented a significant cost to manage and optimize in every business, and now is the time to move the decision making around effective total tax management to its appropriate level of organizational strategic planning.

By moving tax decision making to the strategy table, including those tax professionals equipped to fully understand them, businesses will be able to better manage the risks and demands of these ever increasing costs.

Companies that establish a total tax mindset to take a holistic approach, however, can maximize savings, increase the bottom line, and be ready to face the continued changes ahead.



Contact Us

MATTHEW BECKER
National Managing Partner of Tax
616-802-3413 / mkbecker@bdo.com

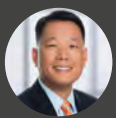
CASSIE HARTOGS
Atlantic Tax Regional Managing Partner
703-770-6335 / chartogs@bdo.com

JOHN MARQUARDT
Central Tax Regional Managing Partner
248-244-6505 / jmarquardt@bdo.com

MATHEW DeMONG
Northeast Tax Regional Managing Partner
617-422-7575 / mdemong@bdo.com

KAREN STONE
Southeast Tax Regional Managing Partner
704-887-4138 / kstone@bdo.com

BILL HICKL
Southwest Tax Regional Managing Partner
713-407-3837 / bhickl@bdo.com



HOON LEE
West Tax Regional Managing Partner
415-490-3247 / hslee@bdo.com

ABOUT BDO TAX

The Tax practice at BDO is among the largest tax advisory practices in the United States. With over 70 offices and more than 750 independent alliance firm locations in the United States, BDO has the bench strength and coverage to serve you.

ABOUT BDO USA

BDO is the brand name for BDO USA, LLP, a U.S. professional services firm providing assurance, tax, and advisory services to a wide range of publicly traded and privately held companies. For more than 100 years, BDO has provided quality service through the active involvement of experienced and committed professionals. At BDO, our purpose is helping people thrive, every day. Together, we are focused on delivering exceptional and sustainable outcomes — for our people, our clients and our communities. Across the U.S., and in over 160 countries through our global organization, BDO professionals provide assurance, tax and advisory services for a diverse range of clients.

BDO is the brand name for the BDO network and for each of the BDO Member Firms. BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. www.bdo.com

Material discussed in this publication is meant to provide general information and should not be acted on without professional advice tailored to your needs.

© 2022 BDO USA, LLP. All rights reserved.

People who know, know BDO.[SM]