White Paper

Global Tax Compliance Driving the Need for Cross-Border Technology

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Kevin Permenter Mickey North Rizza
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IDC OPINION

Cross-border ecommerce is growing rapidly around the world, as many businesses are taking advantage of the speed and ease of selling their products online. However, as cross-border ecommerce continues to grow, many businesses are unexpectedly faced with new tax compliance challenges associated with moving products around the globe. Much like the ever-changing state and local tax laws in the United States, country-level tax and customs regulations are constantly in flux. Added to these challenges, ecommerce companies must also respond to the high demands of their customers, who expect instant gratification via next-day delivery and/or free delivery. To remain competitive and profitable, and to run efficiently, businesses must consider a more streamlined fulfillment process.

Tax software companies are well suited to support the specific compliance challenges associated with cross-border transactions because of their data management capabilities and tax compliance expertise. In fact, many tax software companies are stepping into this role with recent acquisitions related to the growing complexity of cross-border tax and compliance. As a result, more and more ecommerce companies will likely implement tax compliance tools, which are able to cope with the customs, shipping, and fulfilment challenges.

IN THIS WHITE PAPER

This white paper examines the shifting regulatory changes impacting cross-border ecommerce on a global scale. The white paper also describes the complexity inherent to cross-border ecommerce. Further, the white paper explores the role of tax technology in facilitating cross-border transactions.

SITUATION OVERVIEW

Cross-border ecommerce is growing rapidly. Based on data gathered from the National Retail Federation and the U.S. Department of Commerce, traditional retail grew about 4% in 2018. During the same time frame, online retail grew at more than 10%. Cross-border ecommerce is even outpacing domestic ecommerce with a growth rate that is estimated to be 2x that of traditional ecommerce. By 2022, cross-border ecommerce could account for more than 15% of the world's online retail market. At a regional level, there is even more reason for optimism regarding the growth potential for cross-border ecommerce. In Europe, cross-border ecommerce is gaining traction across countries, especially in the

United Kingdom, Germany, Italy, and Spain. In China, IDC sees continuous growth of domestic demand for quality overseas products, which has driven the rapid growth of the overseas purchase market in recent years. In the United States, consumers' online purchases grew by more than 16% year over year.

What Is Driving the Growth in Cross-Border eCommerce?

Cross-border ecommerce has made import and export easier than ever before, allowing websites to provide items more aligned with the rise and fall of customer demand. There are two sides driving the growth and popularity of cross-border ecommerce.

From the customer side, the key motivations are product availability and attractive offerings (price and promotion). Consumers are savvier than ever before; because of the ubiquitous nature of the internet, consumers have access to products and are exposed to product advertising from all over the world. Often trends originating in one part of the world can become highly desirable in another part of the world. Consider the phenomenal popularity of Japanese Manga and its associated products (books, apparel, merchandise, etc.) among U.S. teenagers. Today's consumer has expectations to shop in a truly global marketplace. Further, the average fulfilment times for cross-border deliveries, while still higher than domestic delivery times, have fallen by more than 50% according to many of the largest ecommerce stores. To be sure, speed and the cost of priority shipping methods are still sources of angst for shoppers, but no more so than what shoppers feel regarding domestic ecommerce stores. The hesitancy around cross-border ecommerce related to shipping/fulfilment times has diminished greatly.

From the business side, companies are always looking to grow their reach aggressively by expanding beyond the borders of their home country to explore new global markets. The payoffs for successfully expanding internationally are potentially tremendous and they include more revenue streams (large pools of potential customers) and less exposure to specific country-level economic pressures (i.e., country-specific recessions).

The Amazon Effect

The expectations of the consumer are no different for small ecommerce retailers as they are for larger ecommerce companies like Amazon, Walmart, or Alibaba. For example, smaller ecommerce businesses are struggling to meet consumers' growing expectation for free shipping or two-day shipping. Customers demand instant gratification, seamless experience, and next-day delivery regardless of size of the retailer. As larger ecommerce companies continue to use their resources to influence consumer expectations, the importance of efficient cross-border compliance will continue to grow.

FUTURE OUTLOOK

The cross-border ecommerce economy will continue to expand rapidly. In fact, cross-border ecommerce is projected to grow at twice the pace of domestic ecommerce. As we look to the future of cross-border ecommerce, it is important to consider the following:

- **The rise of cross-border marketplaces.** Cross-border marketplaces are ecommerce sites where product is provided by multiple third parties; popular examples include Alibaba, Amazon, eBay, JD.com, and Wish. These sites are growing rapidly. In fact, in many countries like China, Japan, and the United States, marketplaces are all expected to grow faster than their retail website counterparts. With the rise of these cross-border ecommerce marketplaces, the emphasis will remain on compliance and logistics. Companies must now streamline their customs, logistics, and returns processes to successfully compete in these marketplaces.

- **Consumer trust — a competitive advantage.** In cross-border transactions (both B2B and B2C), the role of trust is incredibly important. Consumers who encounter additional fees that they didn't know they would need to pay in order to receive their products are less likely to become repeat customers and may reject shipments altogether. In many ways, the ability to build and maintain consumer trust represents a distinct competitive advantage. The ability to efficiently manage expectations around landed cost (i.e., total cost of a shipment once it reaches the buyer's doorstep) can address a portion of the trust factor in cross-border transactions.
- **The impact of geopolitical events.** Adding tariffs/taxation at the U.S. border or at the China border would mean that online shoppers pay more for their products. This effect will be felt by any retailer looking to service these markets. The possibility of Brexit and the political tension within the oil-producing Middle Eastern nations may also prompt changes in tax/tariff regulations in the coming years. Considering the relatively thin margins of retail products, trade wars will place even more emphasis on fast and efficient cross-border compliance.

CHALLENGES/OPPORTUNITIES

While the payoff for global expansion and global ecommerce is potentially great, cross-border ecommerce is not without its challenges. The unprecedented growth of cross-border ecommerce has presented several new challenges to businesses. Many of these new challenges revolve around compliance including the following:

- **Determining shipping and insurance costs.** Shipping and insurance costs are essential aspects to ecommerce customer order fulfillment and to customer satisfaction. However, this aspect of ecommerce is complex, involving product attributes like size, weight, and packaging. Shipping rates can also vary based on region (origin country), destination country, season, and even commodity (oil) prices. The makes it difficult to determine final shipment value.
- **Assigning the proper tariff code.** Goods are assigned a tariff code based on their attributes that corresponds to the appropriate customs duty. Assigning tariff codes can be complicated. Often duties can vary widely across items with similar attributes and descriptions, which can lead to a change in duties assigned to the product.
- **Considering *de minimis* thresholds.** The total value of the shipment also plays a role in whether or not the shipment meets the *de minimis* threshold and, if so, it would be eligible for an expediated customs process. While the United States changed its *de minimis* threshold upward from $200 to $800, many other nations maintain very low *de minimis* thresholds.
- **Shifting tax rates.** Indirect taxes like sales and use tax, value-added tax (VAT), and goods and services tax (GST) are critical aspects of the emerging global digital economy. Nearly every major economic region is undergoing some level of indirect tax reform; the countries announcing VAT/GST and other such indirect tax changes include Canada, Malaysia, China, and India.

How Do These Impact the Consumer?

Consumers demand a positive shopping experience from their retailers, or they will likely seek out a competitor for future purchases. Compliance issues play a role in customer satisfaction, particularly when presented with the following:

- **Delivery delays.** Errors in compliance can lead to products getting stuck in customs and thus lead to delivery delays. These delays chip away at the customer's trust of a brand and online store. Negative experiences due to product delivery delays can quickly draw negative reviews that erode a customer base.
- **Product shortages.** Order management is always a challenge, but especially so for smaller cross-border ecommerce companies. The inability to manage compliance challenges can manifest itself in a store not being able to provide the customer with the product he or she is looking for at the right time. Having timely inventory is essential for many online retailers selling items based on time-specific events like championship sports or major political events.
- **Inflated prices.** The inability to manage landed costs or to accurately determine shipment value can result in unnecessary pricing inflation on the part of the online reseller that in turn may need compensation to maintain margins. There may also be an inability to price items for specific regions that may artificially inflate the price the consumer is asked to pay for the product.

Opportunities — Let Compliance and Logistics Be Key Differentiators

More and more, ecommerce companies will need to efficiently manage product compliance and logistics in order to be successful. Guaranteed costs, delivery days, or times and fully transparent track and trace are necessities to compete on the global stage. Fortunately, companies can leverage tax software to achieve the following capabilities:

- **Greater visibility and control.** Organizations that have the right infrastructure for compliance are more likely to achieve the required visibility and control of their ecommerce business' supply chain. Compliance and tax regulations are critical components of the overall product delivery cost. This visibility allows ecommerce businesses to engage in cross-border transactions with certainty and confidence.
- **Navigating of complex customs and regulations.** The customs regulatory landscape is extremely complex, especially cross-border transactions. Many of the regulations have a direct impact on delivery times and total landed cost, which impact profitability. However, utilizing the right software tools and services would turn the complexity inherent to customs and border regulations into an advantage. Tools for accurate landed cost calculation in real time, for example, would allow businesses to provide their customers with complete transparency. With this advantage, ecommerce companies can make and keep promises to their customers.
- **Improving the returns process.** Delivery returns are a fact of life for ecommerce companies. However, these returns are even more impactful in a cross-border environment. Having a strong grip on compliance is a necessity for having an effective return management policy. Return policies are often cited as key differentiators for online customers in choosing where they shop.

CONCLUSION

The digital economy has made it easier and faster to sell products to more countries than ever before. However, growth of the digital economy has introduced many ecommerce businesses to a host of new compliance steps, such as item classification, that aren't present when selling within a singular economic region (i.e., the European Union). Further, the growing amount of tax reform initiatives, changing tariffs, and the increased focus by government agencies on the high volume of packages crossing country borders only add to an already complex situation.

In addition, order management and fulfilment are critical steps for a successful cross-border ecommerce business, and they are often overlooked. When handled correctly, order management and fulfilment improve consumer satisfaction and loyalty. Improper fulfillment and compliance can have a devastating effect on product availability and product delivery times, which are essential aspects of customer satisfaction.

Tax compliance software companies with the expertise and technology to manage cross-border transaction compliance are well positioned to provide businesses with an edge in the global market. Further, many tax compliance software companies are already handling the massive data and regulatory requirements necessary for business to conduct sales transactions in multiple countries. Also, both tax and regulatory compliance documents are often required to process/manage shipments. In those instances, having the tax and regulatory data/documentation in one solution may present process efficiency advantages. In the end, the challenges of cross-border commerce represent a tremendous opportunity for sellers with the right blend of customer focus, supply chain capability, and infrastructure to rapidly expand into international markets.

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Global Headquarters

5 Speen Street
Framingham, MA 01701
USA
508.872.8200
Twitter: @IDC
idc-community.com
www.idc.com
