



THE STATE OF TOBACCO AND VAPE TAX COMPLIANCE

BENCHMARKING YOUR BUSINESS IN 2023

— Research Highlights —

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55% of all the tobacco and vape organizations surveyed incurred penalties or interest from audits over the past year.

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77% of companies are leaning toward implementing a SaaS solution over an on-premises solution for tax compliance.

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Best-in-Class companies are 36% more likely to invest in a single-source tax management solution to automate compliance activities.

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40% of companies are ill prepared to manage the PACT Act and other regulatory requirements.

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Overview

This report analyzes how leading organizations overcome excise tax complexities to efficiently navigate tax compliance challenges, improve their business outcomes, and blaze the path to becoming Best-in-Class.

Modernize Your Excise Tax Management Processes to Alleviate Tax Compliance Burdens

Tobacco and vape organizations have many environmental, health, and business standards to meet, and managing compliance against these regulations can be challenging. Aberdeen Strategy & Research conducted a study of 175 tax experts at tobacco and vape organizations to discover the pain points and best practices associated with excise tax management (see sidebar), which uniquely affects these businesses.

Excise tax, for the purposes of this Aberdeen study, is defined as an indirect tax on tobacco and vape products. This tax is often dependent on the product type, volume, and mode of transport, which makes it very complex and difficult to calculate accurately and efficiently.

Aberdeen research has found that tax professionals at organizations that operate in the tobacco and vape industries are struggling with costly and lengthy tax calculation, filing, and reporting processes. They need powerful solutions to support their excise tax management activities and ensure accuracy for higher-than-standard tax liabilities. This report reveals that leading companies do so by:

- ▶ Prioritizing automation and integration along with key data management, tax calculation, and tax reporting capabilities
- ▶ Integrating tax compliance processes into a single-source solution
- ▶ Utilizing modern excise tax compliance management software

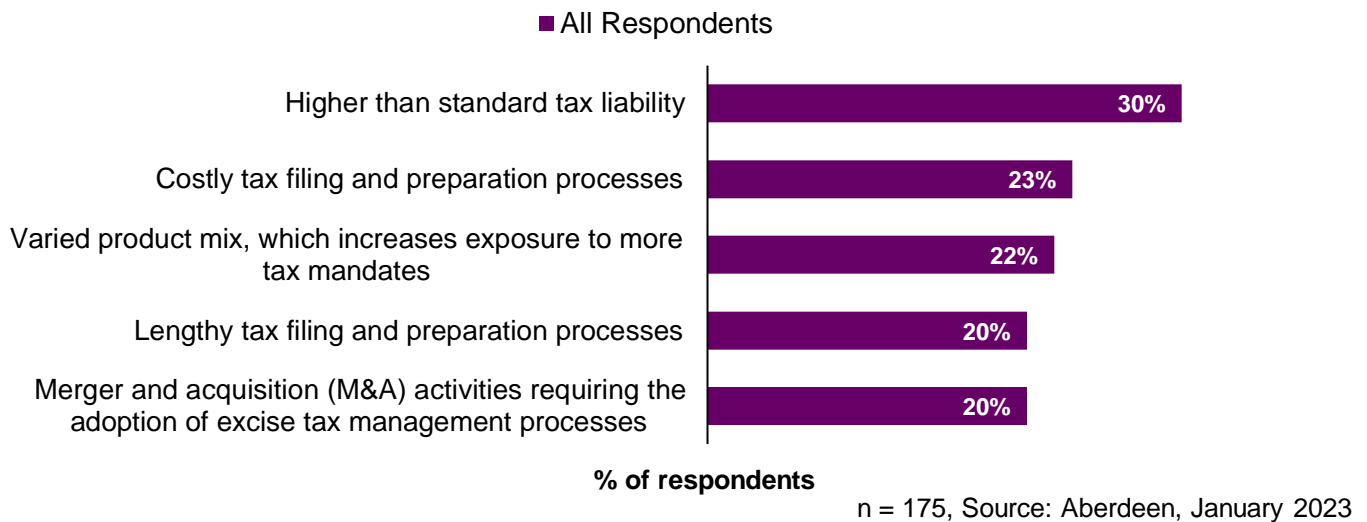
Pressures and Challenges in Excise Tax Management

Excise tax rules and rates vary state-to-state, so as organizations grow, they need to comply with more and more regulations. Tax professionals at tobacco and vape organizations are feeling pressured by the costly and lengthy tax filing and preparation processes, as well as the ability to effectively calculate and report these complex excise taxes (Figure 1).

Tobacco & Vape Excise Tax Management Survey

The 175 respondents in this study were composed of distributors, retailers, manufacturers, wholesalers, suppliers, and eCommerce professionals in the tobacco and vape industries.

Figure 1: Pressures Driving Approaches to Excise Tax Management



The higher-than-standard tax liability for excise taxes puts more pressure on tax professionals to ensure the accuracy of their excise tax calculations, but with a varied product mix and changing compliance regulations, it's hard to keep up.

Tobacco and vape organizations are also faced with several key challenges when managing tax compliance, though it is interesting to note that these challenges vary based on industry. **Tobacco organizations' main challenges with managing tax compliance are:**

- ▶ Maintaining accuracy of tax liability calculations, **35%**
- ▶ Managing data collection, **33%**
- ▶ Struggling with detailed information for calculation and reporting, **33%**

Conversely, **vape organizations have other challenges with managing tax compliance** due to:

- ▶ Staying up to date on changes in tax rates and rules, **42%**
- ▶ Struggling with detailed information for calculation and reporting, **33%**
- ▶ Managing changing forms for thousands of jurisdictions, **32%**

As shown here, the compliance challenges for tobacco companies are based more around working with complex data and reporting processes. Vape companies are more challenged by the rapidly changing landscape, which brings with it additional regulations that are harder to get a grasp on and keep up to date with.

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Reporting specifically brings on several other issues for these companies. Not only are they having difficulties with the complexity involved in reporting and filing, but they also struggle with the time to complete and update filing forms, especially when they're lacking key staff with specific tax filing knowledge. The loss of tax filing and reporting skills has worsened over the past year (see sidebar). Respondents surveyed in 2023 are 44% more likely to cite this as a top reporting and filing challenge than those in 2022 (35% vs. 24%). There are also a few key differences in the challenges with reporting and filing between tobacco and vape organizations.

Tobacco companies struggle with:

- ▶ Complexity of tax reporting/filing rules and regulations, **40%**
- ▶ Lengthy time to update filing forms in response to legislation changes, **34%**
- ▶ Lengthy time to conduct reporting/filing for excise taxes, **33%**

Vape organizations face the following reporting/filing challenges:

- ▶ Lengthy time to conduct reporting/filing for excise taxes, **39%**
- ▶ Inability to keep up with changing reporting/filing regulations, **36%**
- ▶ Lack of excise tax expertise or knowledge, **35%**

Due to the multiple pressures and challenges shown above, many organizations are turning to tax compliance management providers in 2023 to support their processes and reporting. Disorganized, manual, spreadsheet-based tax calculations and reporting are error-prone and often lead to additional costs and time spent on reconciliation and review. These inefficient excise tax compliance management processes can result in audit penalties and interest, which place a financial burden on the organization.

55% of all the tobacco and vape organizations surveyed incurred penalties or interest from audits over the past year. Broken out by industry, 57% of tobacco organizations and 48% of vape organizations incurred penalties.

For **tobacco organizations**, the main causes are due to:

- ▶ Excise tax rate or rule errors, **49%**
- ▶ Excise tax liabilities, **46%**

While for **vape organizations**, the top causes are:

- ▶ Late payments, **50%**
- ▶ Late filings, **46%**

Year-over-year Impact of Tax Professional Attrition

Percentage of tobacco and vape companies citing **lack of excise tax expertise or knowledge** as one of their top challenges with tax reporting and filing:

- ▶ 2022, **24%**
- ▶ 2023, **35%**

As a result, among the organizations who incurred penalties from audits over the past year, the percentage of those who said their penalties were **because of excise tax rate or rule errors** increased from 38% to 55%, showing how the loss of knowledge has impacted the accuracy of reporting and filing.

Additionally, the percentage of respondents citing **eliminating manual processes** as a top criterion for new solutions **increased from 18% in 2022 to 27% in 2023**, demonstrating their desire to put limited resources toward the most valuable tasks.

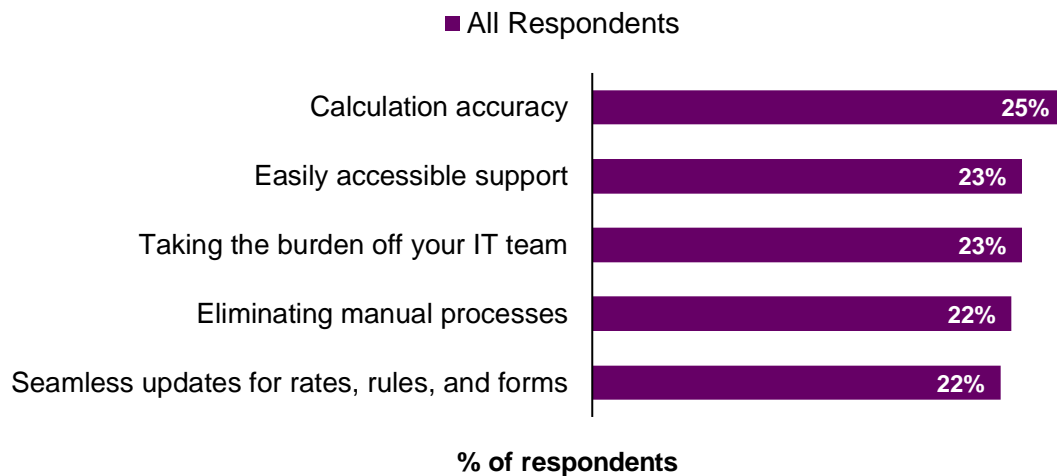
55%

of respondents incurred penalties or interest from audits over the past year.

Drivers to Invest in Tax Compliance Management Solutions

The need for support, accuracy, and modernization drives companies to invest in excise tax compliance solutions (Figure 2).

Figure 2: Criteria for Deciding to Implement a Tax Solution



n = 175, Source: Aberdeen, January 2023

Calculation accuracy is the number one quality that companies look for in a tax compliance management provider and, as shown earlier, is critical for companies looking to implement a new tax solution. The higher-than-standard tax liability for excise taxes places even more pressure on tax professionals to accurately manage their own excise taxes. A solution that enables greater accuracy of tax calculations reduces audit penalties and interest and eases the burden on tax and IT teams, making another important case for investments in excise tax compliance management technology.

Having support that is easily accessible is another important criterion when companies are looking for a tax solution provider. This could be due to the loss of tax expertise as experienced tax professionals transition out of the workforce, leaving many organizations with a lack of excise tax knowledge. As a result, companies are turning to software providers for guidance on tax rules and rates. 77% of companies in Aberdeen's sample are leaning toward implementing a SaaS solution over a singular on-premise solution for tax compliance. The greater support and expertise available from a SaaS vendor helps organizations stay on top of their excise tax management amidst internal changes, such as expansions of

77%

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product lines and sales channels, and external changes, such as tax rule and rate changes.

For those companies that haven't yet invested in tax compliance management technology, a way that tobacco and vape organizations are attempting to alleviate the burden on their tax professionals is to outsource some key processes. These also differ by industry.

The top three processes that organizations outsource are:

Tobacco:

- ▶ Tracking regulatory changes, **38%**
- ▶ Managing information for calculation and reporting, **34%**
- ▶ Managing form changes across jurisdictions, **33%**

Vape:

- ▶ Handling amended returns, **44%**
- ▶ Managing information for calculation and reporting, **34%**
- ▶ Data management/data collection, **34%**

Though outsourcing may temporarily alleviate some employee burden, the cost associated with it would be much better directed towards an investment in tax compliance management software.

Drive Value and Overcome Challenges by Using Tax Compliance Management Software

Based on the research above, it's evident that tax management burdens are a significant challenge for tobacco and vape organizations, and tax compliance management solutions are designed to alleviate these burdens. But which technologies and capabilities are the most influential at streamlining and improving the accuracy of calculation and reporting processes? To answer this question, let's look at what the Best-in-Class are utilizing.

Best-in-Class organizations are defined by Aberdeen as the top 20% of companies based on their performance in key excise tax compliance management metrics (see sidebar). Best-in-Class companies have faster tax compliance processes and greater accuracy than All Others, resulting in fewer audit costs and greater operating margins (Table 1).

Though outsourcing may temporarily alleviate some employee burden, the cost associated with it would be much better directed towards an investment in tax compliance management software.

To evaluate maturity, Aberdeen classified respondents into one of two categories based on their self-reported performance across several key metrics highlighted in Table 1:

- ▶ **Best-in-Class:** Top 20% of respondents based on performance
- ▶ **All Others:** Bottom 80% of respondents based on performance

Table 1: Maturity Matrix for Excise Tax Compliance Management

Year-over-Year Performance Metric (n=175)	Best-in-Class (n=36)	All Others (n=139)
Change in cycle time of tax compliance processes over the past 2 years	-33%	+6%
Change in cost of audits , including fines/penalties/corrective labor over the past 2 years	-34%	+5%
Change in operating margins over the past 2 years	+36%	-1%

With streamlined processes in place for managing their excise taxes and implementing updates in accordance with legislation changes, Best-in-Class companies saw on average a 33% decrease in the cycle time of their tax compliance processes over the past two years while All Others saw an increase. Best-in-Class companies also had more accurate excise tax calculations and thus were less likely to incur fines and penalties from audits. These time and cost benefits for top performers contributed to an advantage in overall operating margins.

To achieve these higher levels of performance, the Best-in-Class have implemented a comprehensive suite of technologies to support their end-to-end tobacco and vape tax compliance activities (Figure 3).

They are investing in automation to ease the burden on their tax and IT teams and minimize time spent on tedious filing processes. Figure 3 on the next page shows that Best-in-Class companies are **38% more likely** to have an automated solution to manage excise tax calculations (69% vs. 50%) and **56% more likely** to have an automated solution to manage excise tax returns (50% vs. 32%).

Best-in-Class companies are

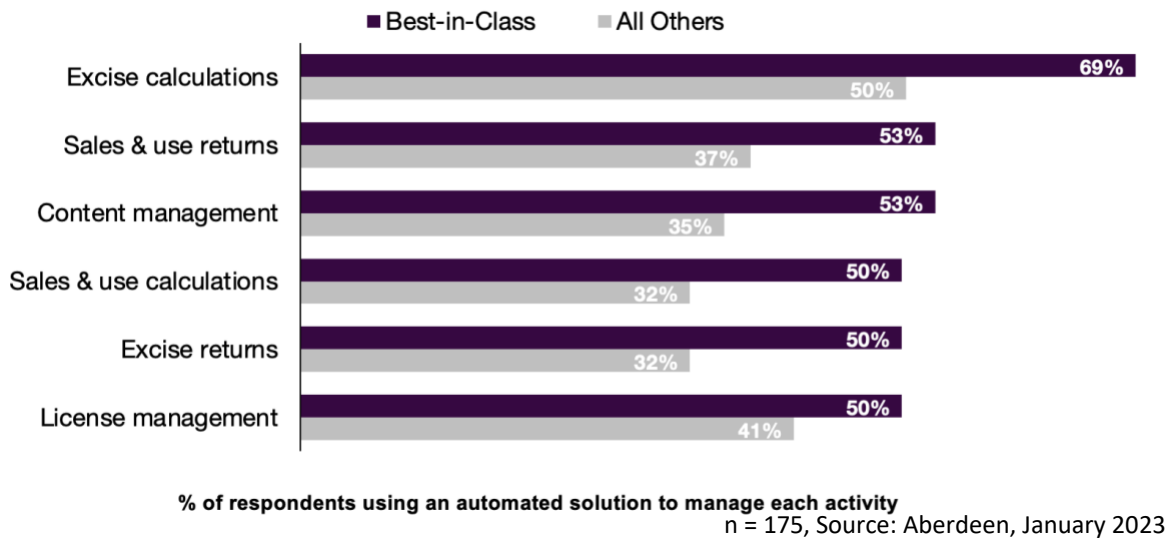
38%

more likely to **automate excise tax calculations** and

56%

more likely to **automate excise tax returns**.

Figure 3: The Best-in-Class Are More Likely to Leverage Automation



Greater automation for excise tax calculations reduces the number of manual errors and thus costly penalties. Automation for excise and sales and use tax returns eliminates manual data entry and alignment with changing tax structures, which improves reporting accuracy and frees up employee time for more strategic activities. Content and license management are key capabilities for tobacco and vape tax management that pair well with calculation and reporting automation. Automation in these areas can streamline the implementation of updates as legislation changes occur, ensuring the organization remains compliant across states and jurisdictions. When combined into a single-source tax management solution, these capabilities become even more powerful.

The Power of a Single-Source Tax Management Solution

In addition to investing in automation for tax compliance management, Best-in-Class companies integrate their tax management technologies into a single-source solution. Compared to All Others, the **Best-in-Class are 36% more likely to implement a single-source solution** for tax compliance management. When analyzing by industry, Best-in-Class tobacco organizations are 20% more likely to implement a single-source solution, while Best-in-Class vape organizations are 63% more likely.

Having a single-source solution is a common characteristic of the Best-in-Class, but it is also interesting to isolate all companies using a single-source solution and compare their performance to companies that aren't using a single-source solution. When considering business improvements for single-source solution users, organizations that have already invested

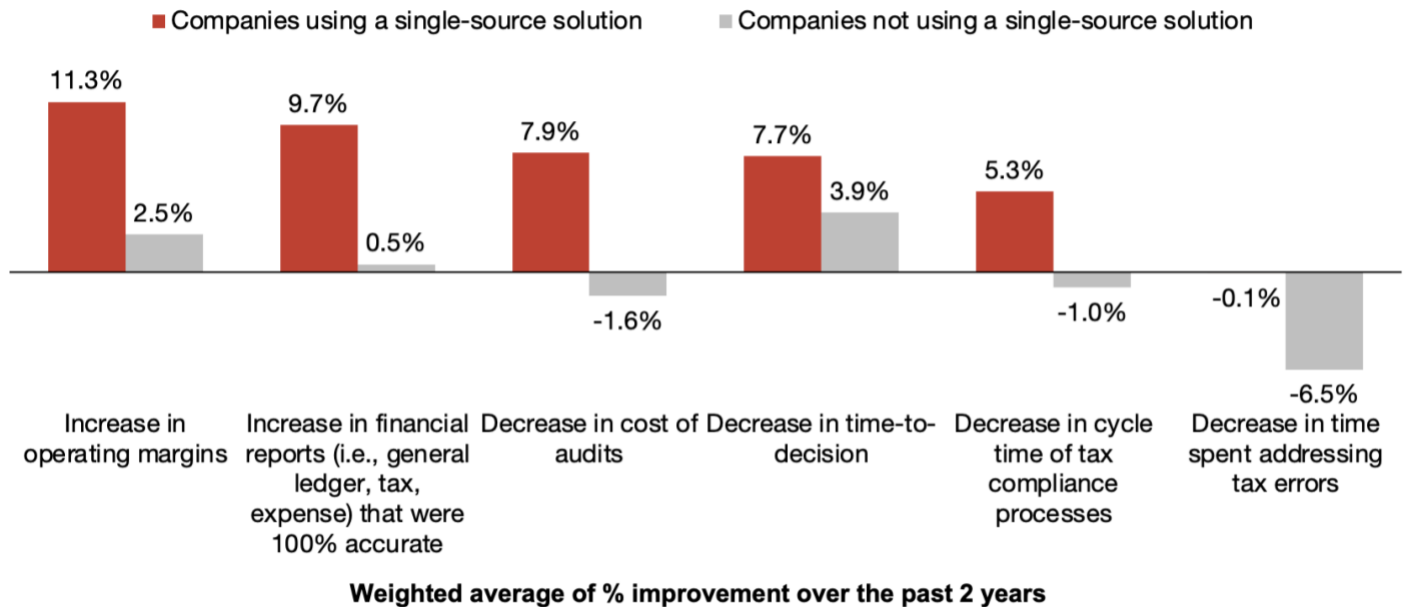
Adoption of a Single-Source Solution for All Tax Management Activities

- ▶ Best-in-Class: **64%**
- ▶ All Others: **47%**

Best-in-Class companies are **36% more likely** to implement a single-source solution compared to All Others (64% vs. 47%).

in a combined platform for all tax compliance management activities are experiencing greater improvements in operating margins, report accuracy, and time-to-decision, while decreasing audit costs and cycle time of tax compliance processes (Figure 4).

Figure 4: Business Improvements for Single-Source Solution Users



n = 175, Source: Aberdeen, January 2023

A single-source solution reduces the manual errors and time spent reconciling and aggregating information from multiple disparate data sources. This has helped single-source solution users achieve a greater improvement in the accuracy of financial reporting, including general ledger, tax reports, and expense reports, over the past two years. Acting as a centralized location to access information on tax rules and rates, a unified solution makes it easy to keep up with legislation changes. The time saved by integrating all tax management technologies into one platform can be diverted to decision-making and more strategic initiatives.

Having a unified solution streamlines integration with other business applications such as ERP and BI/analytics systems. The centralized platform is a single source of truth for disseminating tax information to other parts of the organization. Companies using a single-source solution experience a greater decrease in time-to-decision, which will help them get ahead of their competitors. With faster, more accurate delivery of tax data, executives are better equipped to make decisions and take advantage of new business opportunities. As companies look to scale their business and integrate their solutions into a single platform,

partnerships with SaaS vendors can be extremely influential. SaaS for excise tax management helps organizations grow and develop new products and services without the fear of miscalculating tax rates, missing filing deadlines, and failing audits.

Best-in-Class Results

Prioritizing automation and integration along with key data management, tax calculation, and tax reporting capabilities, has placed the Best-in-Class above the rest. These top performers rate themselves higher than All Others on overall compliance, ease of use, and how well their solutions meet their indirect tax needs (Table 2).

Table 2: Rating of Excise Tax Compliance Performance (1-10 scale)

% of respondents rating their performance an 8, 9, or 10 (n=175)	Best-in-Class (n=36)	All Others (n=139)
How well do you feel your organization's solutions meet its indirect tax needs?	67%	52%
How compliant do you think your organization is?	81%	59%
How easy is it to maintain your excise tax calculation solution as your business and legislation changes?	64%	47%
How easy is it to maintain your excise tax reporting solution as your business and legislation changes?	86%	56%

Higher ratings in ease of maintaining tax calculation and reporting solutions as business and legislation changes occur show that the Best-in-Class are better positioned to expand their business and advance into new jurisdictions. A unified platform for all tax activities, including sales and use tax, helps to support a single source of truth for the entire organization. With systems that are easy to maintain and better to meet their needs, tax professionals are more satisfied with their solutions. Compared to All Others, Best-in-Class companies are **34% more likely** to be extremely satisfied with their current tax compliance solutions. Greater employee satisfaction leads to greater retention and prevents the loss of tax experts.

Compared to All Others, Best-in-Class companies are

34%

more likely to be **extremely satisfied** with their current tax compliance solutions.

Key Takeaways

Tobacco and vape organizations need modern solutions to support their excise tax management processes and alleviate the tax burdens on their tax teams. Best-in-Class companies exhibit the best of modern tax solutions in action, and they deploy comprehensive, unified tax solutions to streamline excise tax management activities. When reflecting on the importance of optimizing excise tax management processes, there are three key points to highlight:

- ▶ Automation saves companies time and money throughout their excise tax compliance management processes.
- ▶ Integrating tax compliance processes into a single-source solution streamlines updates from regulation changes and improves accuracy in tax calculation and reporting.
- ▶ Modern excise tax compliance management software sets organizations up for success and enables them to expand into new markets (new products, jurisdictions, locations/regions).

During times of economic instability, tobacco and vape companies can't afford to lose money due to inaccurate tax payments or audit penalties/interest. These companies need systems in place to remain agile and prepare for whatever comes next. They also need to optimize flexibility as they address fluctuations in demand resulting from economic downturns and changing regulatory requirements such as the PACT Act. Currently, 40% of organizations are still unsure of how they plan to handle PACT Act reporting requirements or have a manual workaround (see sidebar). Increased agility in excise tax management is critical for organizations to succeed in the long-term. By following in the footsteps of the Best-in-Class and investing in automation and integration, organizations can begin to prepare for the future.

Readiness for the PACT Act

How is your organization preparing for PACT Act reporting requirements?

- ▶ Included in existing tax solution, **31%**
- ▶ Custom solution, **25%**
- ▶ Exploring solutions, **21%**
- ▶ Manual workaround, **19%**
- ▶ Currently outsource compliance, **5%**

Related Research

- ▶ *Communications Tax Agility in the Face of Change: Diminishing Risk and Positioning for Growth*; **December 2021**
- ▶ *Streamline Tax Reporting and Calculations: The Power of Automation for Excise Tax Management*; **November 2021**
- ▶ *Strategically Manage and Leverage the True Value of Finance Data*; **May 2021**

About Aberdeen Strategy & Research

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