



## *Public Competition Assessment*

*19 November 2009*

### *Thomson Reuters (Professional) Australia Limited - proposed acquisition of Ernst & Young's tax compliance software products business*

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#### **A Introduction**

1. On 14 October 2009, the Australian Competition and Consumer Commission (ACCC) announced its decision to oppose the proposed acquisition of Ernst & Young's tax compliance software products business by Thomson Reuters (Professional) Australia Limited (**proposed acquisition**). The ACCC was of the view that the proposed acquisition would be likely to have the effect of substantially lessening competition in the national markets for the supply of income tax compliance software and for the supply of fringe benefits tax (**FBT**) compliance software in contravention of s. 50 of the *Trade Practices Act 1974* (the **Act**).
2. The ACCC formed its view on the basis of the information provided by the merger parties and information arising from its market inquiries. This Public Competition Assessment outlines the basis on which the ACCC has reached its decision on the proposed acquisition, subject to confidentiality considerations.

#### **B Public Competition Assessment**

3. To provide an enhanced level of transparency and procedural fairness in its decision making process, the ACCC issues a Public Competition Assessment for all transaction proposals where:
  - a merger is opposed;
  - a merger is subject to enforceable undertakings;
  - the merger parties seek such disclosure; or
  - a merger is not opposed but raises important issues that the ACCC considers should be made public.
4. This Public Competition Assessment has been issued because the proposed acquisition was opposed by the ACCC.

5. By issuing Public Competition Assessments, the ACCC aims to provide the public with a better understanding of the ACCC's analysis of various markets and the associated merger and competition issues. It also alerts the public to the circumstances where the ACCC's assessment of the competition conditions in particular markets is changing, or likely to change, because of developments.
6. Each Public Competition Assessment is specific to the particular transaction under review by the ACCC. While some transaction proposals may involve the same or related markets, it should not be assumed that the analysis and decision outlined in one Public Competition Assessment will be conclusive of the ACCC's view in respect of other transaction proposals, as each matter will be considered on its own merits.
7. Many of the ACCC's decisions will involve consideration of both non-confidential and confidential information provided by the merger parties and market participants. In order to maintain the confidentiality of particular information, Public Competition Assessments do not contain any confidential information or its sources. While the ACCC aims to provide an appropriately detailed explanation of the basis for the ACCC decision, where this is not possible, maintaining confidentiality will be the ACCC's paramount concern, and accordingly a Public Competition Assessment may not definitively explain all issues and the ACCC's analysis of such issues.

## **C The parties**

### **The acquirer: Thomson Reuters (Professional) Australia Limited**

8. Thomson Reuters (Professional) Australia Limited (**Thomson Reuters**) is a wholly-owned subsidiary of Thomson Reuters Corporation, a corporation based in the US. Thomson Reuters Corporation currently has a presence in 93 countries and employs approximately 50,000 employees.
9. Thomson Reuters Corporation is a global provider of technology and integrated, information management and publishing solutions for tax and corporate professionals in accounting firms, corporations, law firms, government, and for academics and students. Thomson Reuters Corporation was formed following Thomson's acquisition of Reuters in 2008.
10. In Australia, Thomson Reuters currently supplies the following tax software products: *PowerTax*; *N-ABLE*; *Company Tax Kit*; *PowerTax FBT*; *FBT Simplifier*; *FBT Toolkit*; and *Tax Effect Accounting Toolkit*. Table 1 provides further detail of these products.
11. Thomson Reuters acquired the majority of its tax software products from three of the 'big four' accounting firms in the last two years. Specifically:
  - *PowerTax* and *PowerTax FBT* from PricewaterhouseCoopers (**PwC**) in 2007; and

- *N-ABLE, FBT Simplifier and Company Tax Kit* from Allume Technology Partners Pty Ltd (a joint venture between Deloitte and KPMG) (**Allume**) in 2008.
12. The ACCC understands that these accounting firms sold their products to Thomson Reuters primarily because they considered it was not their core business to be a software provider. Another reason given was their increasingly limited ability to sell tax compliance software products to their audit clients following the introduction of auditor independence rules in the United States and other countries around the world.
  13. Thomson Reuters' other tax software product —the *Tax Effect Accounting Toolkit* — was developed and authored by Moore Stephens on behalf of Thomson Reuters.

#### **The target: Ernst & Young**

14. Ernst & Young is a member company of Ernst & Young Global Limited (**EYG**), a UK private company limited by guarantee. EYG is a global professional services firm providing advisory services across core service lines of assurance, advisory and taxation.
15. In Australia, Ernst & Young currently supplies the following tax compliance software products: *Tax Integrator*, *Global Integrator* and *FBT Organiser*. Table 1 provides further detail of these products.

#### **Other industry participants**

16. Moore Stephens is a national network of six affiliated independent firms providing business advice and chartered accounting services. Moore Stephens supplies a software product for income tax compliance activities called *Complete Tax Solutions*.
17. The National Tax & Accountants' Association (**NTAA**) is a not-for-profit organisation that provides support to its 7,000 member firms, including practical tax advice to assist taxation practitioners and businesses. The NTAA supplies a software product for FBT compliance activities called *FBT Return Preparer*.
18. A number of other organisations supply suites of accounting and practice management software which include products for the preparation of income tax and, in some cases, FBT returns. This software is targeted to tax and accounting professionals (for predominantly small to medium enterprise (**SME**) clients). The suppliers include MYOB, CCH Australia, Reckon Group and Sage Software Australia.

Table 1 **Tax software products of the merger parties**

<i>Supplier</i>	<i>Name of product</i>	<i>Description</i>
<b>Income tax software products</b>		
Thomson Reuters	PowerTax	<ul style="list-style-type: none"> <li>• Developed by PwC and acquired by Thomson Reuters in 2007</li> <li>• Has tax return, tax effect accounting and trusts modules</li> <li>• Can be hosted on a customer's server or intranet or on the web</li> <li>• Also available in 'Lite' version on CD-ROM.</li> </ul>
	N-ABLE	<ul style="list-style-type: none"> <li>• Developed by Allume, acquired by Thomson Reuters in 2008</li> <li>• Has tax return and tax effect accounting modules</li> <li>• Can be hosted on intranet or the web</li> </ul>
	Company Tax Kit	<ul style="list-style-type: none"> <li>• Developed by Allume, acquired by Thomson Reuters in 2008</li> <li>• Prepares tax returns, no tax effect accounting functionality</li> <li>• Spreadsheet based product</li> </ul>
	Tax Effect Accounting Toolkit	<ul style="list-style-type: none"> <li>• Authored by Moore Stephens for Thomson Reuters in 2005</li> <li>• Does not prepare tax returns, tax effect accounting only</li> </ul>
Ernst & Young	Tax Integrator	<ul style="list-style-type: none"> <li>• Similar functionality to <i>PowerTax / N-ABLE</i> (tax effect accounting and tax returns) plus electronic lodgement capability</li> <li>• Can be hosted on customer's server or intranet or on the web</li> </ul>
	Global Integrator	<ul style="list-style-type: none"> <li>• Caters for multinational companies with multi-jurisdictional reporting requirements</li> </ul>
<b>FBT software products</b>		
Thomson Reuters	PowerTax FBT	<ul style="list-style-type: none"> <li>• Developed by PwC and acquired by Thomson Reuters in 2007</li> <li>• Prepares and produces FBT return</li> <li>• Spreadsheet-based</li> </ul>
	FBT Simplifier	<ul style="list-style-type: none"> <li>• Developed by Allume, acquired by Thomson Reuters in 2008</li> <li>• Prepares and produces FBT return</li> <li>• Database configuration</li> </ul>
	FBT Toolkit	<ul style="list-style-type: none"> <li>• Authored by Moore Stephens for Thomson Reuters</li> <li>• Prepares and produces FBT return</li> <li>• Spreadsheet-based</li> </ul>
Ernst & Young	FBT Organiser	<ul style="list-style-type: none"> <li>• Prepares and produces FBT return</li> <li>• Spreadsheet based</li> </ul>

## **D Industry background**

### **Tax compliance activities**

19. Companies undertake a range of tax compliance activities which include:
- gathering, analysing and interpreting financial data for tax planning and provisioning (including tax effect accounting<sup>1</sup>);
  - where there are multiple group entities – consolidating financial data into one reporting stream (for the purpose of income tax returns and reporting, a group of affiliated companies are able to file a single consolidated tax return, rather than each entity filing a separate tax return) ; and
  - preparing for external tax reporting requirements (such as lodging income tax returns with the Australian Taxation Office.
20. Two significant types of taxes payable by companies are income tax and FBT, as below:
- income tax is paid on a company's taxable income. If a company has an income tax liability, it is required to lodge a return for the financial year typically ending 30 June; and
  - FBT is paid on certain benefits employers provide to their employees or their employees' associates in place of salary or wages. If a company has an FBT liability, it is required to lodge a return for the FBT year typically ending 31 March.

### **Options available to companies conducting tax compliance activities**

21. In conducting tax compliance activities, companies can potentially choose from the following options:
- undertake all activities in-house (using tax compliance software or in-house developed tax compliance solutions); or
  - outsource all activities to a professional advisor, usually one of the 'big four' accounting firms in the case of large companies (in which case advisors might use tax compliance software); or
  - undertake some activities in-house and outsource some activities, in which case the degree of involvement of the professional advisor varies, from undertaking some of the initial calculations through to reviewing a draft return prepared by the company.

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<sup>1</sup> Tax effect accounting is a method of bringing [income tax expenses](#) into account during the period in which the expenses are incurred, rather than the period in which the income tax is payable.

***Tax compliance software***

22. The software discussed in this section is referred to in this Public Competition Assessment as “tax compliance software”.
23. A number of software products are available to manage the income tax compliance requirements of companies. Software products that currently provide such functionality are *PowerTax* and *N-ABLE* (supplied by Thomson Reuters), *Tax Integrator* (supplied by Ernst & Young) and *Complete Tax Solutions* (supplied by Moore Stephens).
24. These products provide companies with what is described as an ‘end to end’ process, enabling them to attend to income tax compliance activities and simplifying the process of internal and/or external review of financial reports. These products are also used by the ‘big four’ accounting firms in providing tax advisory services to some of their clients (generally to their larger clients).
25. Inquiries indicated that the core functionality offered by income tax compliance software is likely to include all four of the following:
  - automated data input (including mapping to and from Enterprise Resource Planning (**ERP**)/financial systems or uploading from *Microsoft Excel*);
  - tax effect accounting (;
  - multi-entity consolidation/aggregation calculations (including for consolidated tax return preparation); and
  - company tax return form generation.
26. These products are most often supplied in an ‘off the shelf’ format, although some can be customised for a particular company’s requirements. The products are supplied under licence with many contracts being 3 years in duration with licence fees paid annually. The licence fee tends to include software support and some training.
27. For FBT compliance, software includes *PowerTax FBT*, *FBT Simplifier* and *FBT Toolkit* (supplied by Thomson Reuters), *FBT Organiser* (supplied by Ernst & Young) and *FBT Return Preparer* (supplied by the NTAA).
28. Similar to income tax compliance, these products provide a highly automated process for customers. Product features tend to include:
  - automated data input and rollover (some products only have manual data input);
  - multi-user access;
  - export functions, such as exporting data to payroll systems; and
  - capability to aggregate and report FBT details in a variety of ways, such as by type of benefit, by employee, by employer/group/division, for both external and internal reporting.

### ***Other tax compliance solutions***

#### *Other software*

29. There are other types of software that can be used by a company or an accountant/tax advisor as part of the compliance process for income tax and FBT — tax return software, ERP modules and general book keeping software.
30. Tax return software, such as *APS Advance Tax*, *MYOB Tax* (formerly *Solution 6*), Sage Handisoft's *HandiTax* and CCH's *ProSystem Tax*, is primarily marketed to accountants. Thomson Reuters also supplies a tax return software product called *Company Tax Kit* which is primarily marketed to companies.
31. As the name suggests, this type of software is used primarily to prepare tax returns. The software can also be used to produce some reports. Some software allows tax return forms to be submitted electronically.
32. Tax return software that is marketed to accountants tends to have additional functionalities that assist accountants with the management of their practices (the software forms part of an accounting and practice management software suite). Accountants primarily use this software for their clients, and clients provide the input data in compatible files (including book keeping software files – discussed below).
33. Tax return software does not have tax effect accounting functionality or consolidation/aggregation functionality and has less reporting functionality compared with tax compliance software. In contrast to tax compliance software, this type of software does not provide companies with an 'end to end' process, as described above.
34. General book keeping software includes *Quicken* and *MYOB Accounting*. Such software allows SMEs to prepare basic records including journals, profit and loss statements, trial balances, and can be used to prepare some tax statements such as Business Activity Statements. However, this software cannot prepare tax returns or conduct tax effect accounting activities.
35. Many large companies use modules in ERP systems, such as those supplied by SAP or Oracle, for numerous business needs. However, no modules have been specifically designed for tax compliance activities and these systems are considered to be unsuitable for this purpose by market participants.

#### *In-house developed tax compliance solutions*

36. In-house developed tax compliance solutions are often based on spreadsheet applications (e.g. *Microsoft Excel*) or sometimes using other methods such as database platforms. These are usually developed internally, although some companies engage external service providers to develop customised solutions.

37. All functionality to conduct tax compliance activities needs to be built into the solution by a company or by a software consultant at the request of a company. Given this, the functionality built into individual in-house solutions tends to vary significantly — from the quite simplistic (only allowing for basic aggregation and generation of totals to load into the tax return) to the more sophisticated (allowing for full tax compliance including a range of reporting functionality, complex consolidation functionality, sophisticated tax effect accounting, foreign exchange conversions, depreciation, R&D calculations etc.).
38. However, in-house developed tax compliance solutions generally have some functional limitations, e.g. spreadsheet based solutions cannot automatically generate/populate a tax return form and tax returns cannot be submitted electronically.

## **E ACCC review timeline**

39. The following table outlines the timeline of key events in this matter.

Date	Event
06-Jul-2009	ACCC commenced review under the Merger Review Process Guidelines.
27-Jul-2009	Closing date for submissions from interested parties.
19-Aug-2009	ACCC published a Statement of Issues outlining preliminary competition concerns.
27-Aug-2009	ACCC requested further information from merger parties. ACCC timeline suspended pending receipt of this information.
01-Sep-2009	Former proposed date of 23 September 2009 for announcement of ACCC's findings, amended to allow the merger parties to provide further information.
10-Sep-2009	Closing date for submissions relating to Statement of Issues.
24-Sep-2009	ACCC received further information from the merger parties. ACCC timeline recommenced.
05-Oct-2009	Former proposed date of 7 October 2009 for announcement of ACCC's findings amended in response to a request by Thomson Reuters to allow it additional time to provide further information to the ACCC. ACCC timeline suspended pending receipt of this information.
08-Oct-2009	ACCC received further information from Thomson Reuters. ACCC timeline recommenced.
14-Oct-2009	ACCC announced it would oppose the proposed acquisition.



## **F Market inquiries**

40. The ACCC conducted extensive market inquiries in relation to the proposed acquisition. A range of interested parties provided responses including competitors, potential market entrants, companies that use the tax compliance software products for their tax compliance function, companies that do not use the tax compliance software products and other interested third parties.

## **G Statement of Issues**

41. On 19 August 2009, the ACCC published a Statement of Issues regarding the proposed acquisition. The Statement of Issues sought further comments from market participants on the likely market definition identified by the ACCC and on the ACCC's preliminary view that the proposed acquisition:
- *was likely to substantially lessen competition* in the national market for the supply of income tax compliance software to large companies; and
  - *may raise substantial concerns* in the national market for the supply of FBT compliance software.
42. The Statement of Issues is available on the ACCC's website at [www.accc.gov.au/statementsofissues](http://www.accc.gov.au/statementsofissues).

## **H With/without test**

43. In assessing a merger pursuant to s. 50 of the Act, the ACCC must consider the effects of the transaction by comparing the likely future state of competition if the transaction proceeds (the "with" or "factual" position) to the likely future state of competition if the transaction does not proceed (the "without" or "counterfactual" position).
44. Following extensive inquiries, the ACCC was of the view that, without the merger, it was likely that the tax compliance software products business currently operated by Ernst & Young would continue as a competitive presence in the market. Accordingly, the ACCC adopted this view as part of the counterfactual in applying the with/without test in this matter.

## **I Market definition**

45. The ACCC considered that the relevant markets in this matter were:
- the national market for the supply of income tax compliance software; and
  - the national market for the supply of FBT compliance software.

## **Supply of income tax compliance software market**

### **Geographic dimension**

46. Given that income tax software products are developed specifically for the requirements of the Australian taxation regime and are marketed and sold to customers nationally, the ACCC took the view that the geographic dimension of the market for the supply of income tax compliance software was national.

### **Product dimension**

47. In the Statement of Issues, the relevant income tax product market was identified with reference to large companies. The ACCC's preliminary view was that the software products of the merger parties and Moore Stephens constituted possible substitution options for large companies because these products offered the core functionality required by such companies. After further consideration, the ACCC considered it was more appropriate to identify the market based on the core functionality provided by the income tax compliance software products.
48. On the basis of extensive market inquiries, the ACCC considered that the core functionality offered by income tax compliance software is likely to include all of the following elements:
1. automated data input (including mapping to and from ERP/financial systems or uploading from *Microsoft Excel*);
  2. tax effect accounting;
  3. multi-entity consolidation/aggregation calculations (including for consolidated tax return preparation); and
  4. company tax return form generation.
49. In identifying the scope of the relevant market, the ACCC considered whether the market should be limited to income tax compliance software, or defined more broadly to encompass other tax compliance solutions such as tax return software, ERP systems, general book keeping software, and in-house developed solutions. In particular, the ACCC considered whether or not other tax compliance solutions were sufficiently close demand-side or supply-side substitutes to be included in the same market as income tax compliance software.

### *Demand-side substitutability*

50. The ACCC analysed in considerable depth the extent to which income tax compliance software and other tax compliance solutions could be considered close substitutes on the demand-side. The ACCC sought a large amount of information from both the merger parties as well as a large number of companies in relation to these issues.
51. Market inquiries demonstrated that the majority of companies did not consider other software products (that is, tax return software, ERP systems or general book keeping software), in-house developed solutions or outsourcing to be close substitutes for income tax compliance software.

52. Inquiries revealed that using in-house solutions for income tax compliance involves a manual and lengthy process. There can be costs and difficulties in initially building the solution, and continuing difficulties in periodically updating the solution to ensure consistency with changes in complex tax legislation. It was found that data integrity issues could also pose significant risks. While these difficulties and risks can be minimised by a company, this would require a sizeable investment in terms of time and money.
53. Many customers considered that outsourcing their tax compliance activities to a professional advisor was not a viable option because the cost differential between tax compliance software and outsourcing was considered to be significant. Although some customers did consider outsourcing their tax compliance activities to be an alternative to using income tax compliance software, the ACCC found that professional advisors in fact use income tax compliance software in undertaking tax compliance activities for the majority of clients. Therefore, outsourcing still involves the use of income tax compliance software.
54. Analysis of actual switching between solutions further supported the view that the other income tax compliance solutions were not close substitutes to income tax compliance software.
55. It was found that, over the past two years, only a small proportion of customers switched from their existing income tax compliance software. Of the customers that switched from income tax compliance software, most moved across to an alternative income tax compliance software product. Some customers switched to an in-house solution; only a very small number of customers switched to an outsourced solution. It was found that not one customer switched from income tax compliance software to income tax return software, ERP modules or other general book keeping software.
56. Generally, switching from income tax compliance software to another solution resulted from a change in the client's functional needs. A small number of customers that moved to an in-house solution cited that the income tax compliance software could not meet their specific needs. The majority of customers that moved to an in-house solution noted that income tax compliance software was too expensive and/or too complex for their relatively simple tax needs. Some of these customers had recently downsized operations whilst others had simply been trialling the income tax compliance software. Some of these customers recognised that, if their tax needs were more complex, in-house solutions would not have been a possible alternative.
57. Market inquiries indicated that some switching from in-house solutions to income tax compliance software did occur.

58. The ACCC found that switching from an in-house solution to income tax compliance software generally happened as a one-off change, reflecting technological advances, the growth or increasing complexity of the company or the increasing complexity of tax legislation. The ACCC found that there was some suggestion of asymmetric substitution between in-house solutions and income tax compliance software. That is, income tax compliance software may, to some extent, provide a substitute for users of in-house solutions (hence the observation of some actual switching of customers from in-house solutions to tax compliance software). However, for users of tax compliance software, an in-house solution was not a close substitute due to the factors outlined above and because those customers had not maintained the knowledge and skills needed for an in-house solution.

*Supply-side substitutability*

59. On the supply side, the ACCC explored whether other software providers could build further functionality into their respective products and market those products quickly and without significant investment to supply an income tax compliance software product.
60. Market inquiries with providers of tax return and other software revealed that it would take a considerable amount of time to develop and integrate the additional functionality required (such as tax effect accounting functionality) to develop those products to a point where they could provide similar functionality to income tax compliance software. Providers of other software products also noted that the investment associated with the marketing efforts would be significant.
61. The ACCC found that suppliers of other software products could not quickly and without significant investment, build and supply income tax compliance software products, and accordingly, other software products were not considered to be close substitutes on the supply-side.

*Conclusion*

62. The ACCC found that there were no close substitutes on the demand-side for income tax compliance software products. It was found that products such as tax return software and in-house solutions were not close substitutes.
63. The ACCC found that there were no close substitutes on the supply-side for income tax compliance software products as suppliers of other software products could not quickly and without significant investment build and supply income tax compliance software products.
64. On this basis, the ACCC concluded that the relevant market was the national market for the supply of income tax compliance software.

## **Supply of FBT compliance software market**

### **Geographic dimension**

65. Market inquiries revealed that FBT compliance software products are specific to the requirements of the Australian taxation regime and are marketed and sold to customers nationally. Accordingly, the ACCC took the view that the geographic dimension of this market was national.

### **Product dimension**

66. On the basis of market inquiries, the ACCC found that the core functionality offered by FBT compliance software is that it provides for the data entry process, and the calculation and reporting of FBT benefits for the purpose of FBT compliance.
67. In identifying the scope of the relevant market, the ACCC considered whether the market should be limited to FBT compliance software, or defined more broadly to encompass other FBT compliance solutions such as in-house solutions and outsourcing FBT compliance to professional advisors. In particular, the ACCC considered whether or not other solutions were sufficiently close demand-side or supply-side substitutes to be included in the same market as FBT compliance software.

### *Demand-side substitutability*

68. In identifying the scope of the product dimension of this market, the ACCC explored the extent to which other FBT compliance solutions (such as in-house solutions or outsourcing) could be considered close demand-side substitutes to FBT compliance software.
69. Market inquiries revealed that customers do not consider in-house and outsourced solutions to be close substitutes to FBT compliance software because of the extra work and costs associated with using in-house and outsourced solutions. Further, in-house solutions leave the company open to compliance risks because of potential data integrity issues.
70. Analysis of actual switching between solutions supported the view that other FBT compliance solutions are not considered close substitutes for FBT compliance software. Market inquiries showed that there were very few instances of switching from FBT compliance software to another FBT compliance solution or even another FBT compliance software product.
71. It was found that in the small number of cases where customers of the merger parties did switch to another product, those customers switched from FBT compliance software to an in-house FBT solution rather than another FBT compliance software product. However, similar to income tax compliance software, these customers noted that their FBT needs were relatively 'simple' and therefore the software was not a cost effective option for them.

72. It was found that some customers switched from an in-house solution to an FBT compliance software product. However, the ACCC found that such switching occurred not because in-house FBT solutions and FBT compliance software products were close substitutes but rather generally because of changes in the needs or circumstances of the customer. As with income tax compliance software, the ACCC found that there was some suggestion of asymmetric substitution between in-house solutions and FBT compliance software. That is, FBT compliance software may, to some extent, provide a substitute for users of in-house solutions, but for users of tax compliance software an in-house solution was not a close substitute.

*Supply-side substitutability*

73. On the supply side, other software providers noted that they were unlikely to develop FBT compliance software because of time, costs and expertise involved.
74. Accordingly, the ACCC found that suppliers of other software products could not quickly and without significant investment, build and supply FBT compliance software products.

**Conclusion**

75. The ACCC took the view that other software, in-house solutions or outsourcing to a professional advisor were not close substitutes to FBT compliance software on the demand-side, largely because of the extra work and costs involved in using those other solutions.
76. The ACCC found that there were no close substitutes on the supply-side for FBT compliance software.
77. On this basis, the ACCC concluded that the relevant market was the national market for FBT compliance software.

**J Competition analysis**

**Market concentration**

78. The ACCC found that the income tax compliance software market is comprised of four competing software products, namely *PowerTax* and *N-ABLE* (supplied by Thomson Reuters), *Tax Integrator* (supplied by Ernst & Young) and *Complete Tax Solutions* (supplied by Moore Stephens).
79. The ACCC found that the FBT compliance software market is comprised of five competing software products, namely *PowerTax FBT*, *FBT Simplifier* and *FBT Toolkit* (supplied by Thomson Reuters), *FBT Organiser* (supplied by Ernst & Young) and *FBT Return Preparer* (supplied by the NTAA).

80. The ACCC estimated the market shares and post-merger measures of concentration for the income tax compliance software market. Post-acquisition, the merged entity would hold more than a 90% share of licence revenue from income tax compliance software. Accordingly, the ACCC found that the proposed acquisition was likely to result in a significant increase in concentration in an already concentrated market.
81. The ACCC considered that the structure of the market for FBT compliance software is similar to the income tax compliance software market, and that the proposed acquisition was also likely to result in a significant increase in concentration in this already concentrated market.

#### **Availability of substitutes**

82. The ACCC found that only one other competitor would remain in each of the relevant markets post-acquisition — Moore Stephens in the income tax compliance software market and the NTAA in the FBT compliance software market.
83. While their products have comparable functionality to the products of the merger parties, inquiries revealed that these competitors do not currently have a significant market share.
84. Further, documentary evidence reviewed by the ACCC showed that the merger parties competed vigorously with each other, but indicated that the merger parties did not consider Moore Stephens or the NTAA as strong competitors.
85. The ACCC found that Moore Stephens and the NTAA are likely to be constrained from expanding their respective customer bases. While both organisations are in the tax advisory space, market inquiries indicated that most companies do not perceive the products supplied by Moore Stephens and the NTAA as functionally equivalent to the products supplied by the merger parties. Also, the supply of software is not recognised as their core business. Accordingly, the ACCC took the view that it is unlikely that these two providers could attract a sizeable number of customers away from the established products owned by the merger parties in a reasonably mature market.
86. As outlined above, the ACCC found that in-house developed solutions and outsourcing are not close substitutes for tax compliance software and are not in the relevant markets. Nevertheless, the ACCC examined the level of constraint provided by these 'out of market' tax compliance solutions. Extensive market inquiries indicated that these tax compliance solutions would not pose an effective constraint on the merged firm in either of the relevant markets.

#### **Barriers to entry**

87. The ACCC found that barriers to entry are significant in the relevant markets.

88. In the income tax compliance software market, all products to date have been developed by industry tax experts — the ‘big four’ accounting firms and Moore Stephens. The ACCC understands that product development requires a high level of tax expertise and a high level of IT expertise. Market participants have suggested that entry would only be viable if it were through acquisition of an existing product.
89. After consulting widely with a large range of actual and potential competitors, the ACCC found that it would take at least 2 years to develop a greenfield income tax compliance product at a likely cost of around \$2–3 million.
90. The ACCC found that it would be very difficult for a new entrant to attract a critical mass of customers for an income tax compliance software product for a number of reasons including:
  - *A proven track record / strong brand is needed* — given the significant consequences of errors in a company’s income tax compliance, customers of income tax compliance software are risk averse and, as such, will not use software products that do not come with a proven track record, such as customer testimonials, or are not provided under an established brand name. In this respect, potential entrants considered endorsement and/or use by one of the ‘big four’ accounting firms as necessary to attract customers. The ACCC found that the ‘big four’ accounting firms are unlikely to endorse or use a new entrant product, and other customers are unlikely to sponsor entry. Further, the ‘big four’ accounting firms are unlikely to re-enter the market because participation in the income tax compliance software market would distract from their core business, and the auditor independence rules would limit their target market.
  - *There are barriers to customers switching* — a large number of customers are supplied income tax compliance software under 3 year contracts and the costs of implementing a new mode of tax compliance can be substantial in terms of employee training and system setup.
  - *The market is reasonably mature* — while not yet saturated, customer numbers are not likely to grow significantly in the foreseeable future.
91. In respect of the FBT compliance software market, the ACCC found that an FBT compliance software product would take less time and money to develop than an income tax compliance software product.



92. However, the ACCC also found that there is unlikely to be any monoline entry into this market (that is, supplying an FBT compliance software product without a complementary income tax compliance software product) due to lower expected returns, relative to income tax compliance products, and the expectation that a supplier of an FBT compliance product would also supply an income tax compliance product. Also, as with income tax compliance products, a new entrant would be likely to face difficulties in attracting a critical mass of customers because of the reluctance of customers to switch to a new product, the desirability of a product being aligned with one of the 'big four' accounting firms, the existence of 3 year supply contracts and the mature nature of the market. The ACCC found that the 'big four' accounting firms are unlikely to endorse a new product or to re-enter.
93. For the reasons set out above, the ACCC found that new and effective entry in the relevant markets in the foreseeable future was unlikely.

#### **Removal of a vigorous and effective competitor**

94. On the basis of market inquiries and analysis of internal company documents, the ACCC considers that the two merger parties are each other's closest competitors in both the national markets for the supply of income tax compliance software and FBT compliance software.
95. Ernst & Young and Thomson Reuters compete vigorously for each other's customers as well as vigorously for new customers (including those switching from in-house solutions to tax compliance software) in both of the relevant markets. The merger parties compete on price, service levels and on software functionality. The ACCC considers that the proposed acquisition would therefore result in a large reduction in competition at the 'switching' stage and the 'sign up' stage.

#### **Ability to increase prices and profits**

96. Given that the proposed acquisition would have resulted in the removal of Thomson Reuters' closest competitor in markets where barriers to entry are significant and the remaining competitors currently pose a weak competitive constraint and are unlikely to expand significantly, the ACCC found that if the acquisition were to proceed, Thomson Reuters would have the ability to significantly and sustainably increase prices in both markets.
97. In addition, if the merger proceeded, the ACCC found that the merged firm would have the ability to lower service levels in each market without losing a significant number of customers, due to the factors outlined above. Further, there would be less incentive for the merged entity to further develop or improve its products post-acquisition due to the reduction in competition.

#### **Conclusion**

98. In conclusion, the ACCC found that if the proposed acquisition were to proceed, the merged entity would have the ability to significantly and sustainably increase

prices and lower service levels in the markets for the supply of income tax compliance software and the supply of FBT compliance software. Further there would be less incentive for the merged entity to further develop or improve its products in these markets. In contrast, if the proposed acquisition were not to proceed, the ACCC took the view that the tax compliance software business currently operated by Ernst & Young would continue to compete vigorously with Thomson Reuters in relation to the supply of income tax and FBT compliance software products, and continue to effectively constrain the ability of Thomson Reuters to increase prices, or lower service levels.

99. On the basis of the above, the ACCC formed the view that the proposed acquisition would be likely to have the effect of substantially lessening competition in the national market for the supply of income tax compliance software and in the national market for the supply of FBT compliance software in contravention of s. 50 of the Act.