



Australian
Competition &
Consumer
Commission

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Statement of Issues — Thomson Reuters (Professional) Australia Limited - proposed acquisition of Ernst & Young's tax compliance software products

1. Outlined below is the Statement of Issues released by the Australian Competition and Consumer Commission (ACCC) in relation to the proposed acquisition of the tax compliance software products of Ernst & Young Information Systems Pty Ltd (**Ernst & Young**) by Thomson Reuters (Professional) Australia Limited (**Thomson Reuters**) (**proposed acquisition**).
2. A Statement of Issues published by the ACCC is not a final decision about a proposed acquisition, but provides the ACCC's preliminary views, drawing attention to particular issues of varying degrees of competition concern, as well as identifying the lines of further inquiry that the ACCC wishes to undertake.
3. In line with the ACCC's *Merger Review Process Guidelines* (available on the ACCC's website at www.accc.gov.au) the ACCC has established a secondary timeline for further consideration of the issues. The ACCC invites submissions from interested parties in response to the Statement of Issues by 3 September 2009 and anticipates making a final decision by 23 September 2009. However, the anticipated timeline can change in line with the *Merger Review Process Guidelines*. To keep abreast of possible changes in relation to timing and to find relevant documents, market participants should visit the Mergers Register on the ACCC's website at www.accc.gov.au/mergersregister.
4. A Statement of Issues provides an opportunity for all interested parties (including customers, competitors, shareholders and other stakeholders) to ascertain and consider the primary issues identified by the ACCC. It is also intended to provide the merger parties and other interested parties with the basis for making further submissions should they consider it necessary.

Background

5. On 6 July 2009, the ACCC commenced a public informal review of Thomson Reuters's proposed acquisition of Ernst & Young's tax compliance software products.

The merger parties

The acquirer - Thomson Reuters (Professional) Australia Limited

6. 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.
7. Thomson Reuters Corporation is a global provider of technology, integrated information management and publishing solutions for tax and corporate professionals in accounting firms, corporations, law firms, government, and tertiary institutions.
8. In Australia, Thomson Reuters currently supplies the following tax compliance software products for income tax and fringe benefits tax (**FBT**): *PowerTax*; *N-ABLE*; *Company Tax Kit*; *PowerTax FBT*; *FBT Simplifier*; and the *FBT Toolkit*; (together **Thomson Reuters's tax compliance software products**) (table 1).
9. Through its inquiries, the ACCC understands that Thomson Reuters acquired the majority of its tax compliance 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) in 2008.
10. The ACCC understands that Deloitte, KPMG and PwC sold their products following the introduction of auditor independence rules (i.e. these accounting firms were prevented from selling their tax compliance software products to their audit clients).

The target - Ernst & Young Information Systems Pty Ltd

11. Ernst & Young is a member company of Ernst & Young Global Limited (**EYG**), a UK private company limited by guarantee.
12. EYG is a global professional services firm providing business advisory services, including in relation to taxation.
13. In Australia, Ernst & Young currently supplies the following tax compliance software products: *Tax Integrator*; *Global Integrator*; and *FBT Organiser* (together **Ernst & Young's tax compliance software products**) (table 1).

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

<i>Supplier</i>	<i>Name of product</i>
Income tax compliance software products	
Thomson Reuters	<i>PowerTax</i>
	<i>N-ABLE</i>
	<i>Company Tax Kit</i>
Ernst & Young	<i>Tax Integrator</i>
	<i>Global Integrator</i>
FBT compliance software products	
Thomson Reuters	<i>PowerTax FBT</i>
	<i>FBT Simplifier</i>
	<i>FBT Toolkit</i>
Ernst & Young	<i>FBT Organiser</i>

Other relevant parties

14. 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 reporting and compliance purposes for consolidated corporate tax groups called *Complete Tax Solutions*.
15. The National Tax & Accountant's 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 product for FBT compliance activities called *FBT Return Preparer*.
16. A number of 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 professional customers (with predominantly small to medium enterprise (**SME**) clients). The suppliers include MYOB, CCH Australia, Reckon Group and Sage Software Australia.

Industry background

Tax compliance activities

17. Each year companies undertake a range of tax compliance activities which include:
 - gathering, analysing and interpreting financial data for tax planning and provisioning;
 - where there are multiple group entities – consolidating financial data into one reporting stream; and
 - preparing for external tax reporting requirements (such as lodging income tax returns with the Australian Taxation Office (**ATO**)).
18. 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 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 ending 31 March.
19. In conducting tax compliance activities, companies can choose from the following options:
 - undertake all activities in-house (using licensed 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; or
 - undertake some activities in-house and outsource some. 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.

Tax compliance software products

20. Inquiries indicate that there are three broad categories of tax software products:
 - income tax compliance software products for large companies;
 - income tax compliance software products for SMEs; and
 - FBT compliance software products.
21. FBT compliance software products are provided separately to income tax compliance software products.

Income tax compliance software products for large companies

22. The products within this category are *PowerTax*, *N-ABLE* and *Company Tax Kit* (supplied by Thomson Reuters), *Tax Integrator* and *Global Integrator* (supplied by Ernst & Young) and *Complete Tax Solutions* (supplied by Moore Stephens).
23. These products have tax effect accounting and tax return functionality to assist companies in undertaking tax management, compliance and reporting. They provide companies with an “end to end” process — raw data is uploaded, the software allows for various complex calculations to be conducted and then outputs, including tax return forms, are generated.
24. These products are most often supplied in an “off-the-shelf” format but can also be customised for a company's particular requirements. The products are supplied under licence, which is usually renewable annually. The licence fee includes software support and may include some training.

Income tax compliance software products for SMEs

25. Other software products include those supplied by MYOB, CCH Australia (as part of its *ProSystems fx* suite), Reckon Group and Sage Software Australia (as part of its *Sage Handisoft suite*). These products are marketed primarily to accounting firms and are used for the preparation of returns for individuals and small to medium businesses (**SMEs**). These products do not allow for information from a tax effect accounting process to be automatically rolled into the preparation of the tax return, and cannot be used to prepare consolidated income tax returns.

FBT compliance software products

26. The software products available for FBT compliance activities include *PowerTax FBT*, *FBT Simplifier* and *FBT Toolkit* (all supplied by Thomson Reuters), *FBT Organiser* (supplied by Ernst & Young) and *FBT Return Preparer* (supplied by the NTAA).
27. An organisation is most likely to use FBT software when there are a large amount of entries that require aggregation (i.e. a large number of employees with FBT benefits).

In-house developed tax compliance solutions

28. Some companies use tax compliance solutions for income tax and, or alternatively, FBT that they have developed in-house, rather than using a tax compliance software product. Many in-house developed solutions are based on spreadsheet platforms, such as *Microsoft Excel* (**Excel**). A company needs employees with technical tax knowledge and the necessary IT capabilities to implement and maintain an in-house developed solution.

Areas of overlap and market definition

Areas of overlap

29. Thomson Reuters and Ernst & Young overlap in relation to the supply of income tax compliance software products and FBT compliance software products.

Market definition

30. Based on its inquiries, the ACCC considers that the relevant markets are likely to be:
- the national market for the supply of income tax compliance software to large companies (**income tax software market**); and
 - the national market for the supply of FBT compliance software (**FBT software market**).

Income tax compliance software for large companies

31. On the basis of preliminary market inquiries, the ACCC understands that the main customers in this market are large companies with complex income tax compliance needs. Among other things, 'complex income tax compliance needs' mean that there are a large number of entities to consolidate into the one tax return. Large companies also tend to be customers of large accounting firms and have an in-house tax department or specialised tax manager.
32. Market inquiries indicated that most large companies that use income tax compliance software have only three substitution possibilities — Ernst & Young's *Tax Integrator / Global Integrator*; Thomson Reuters's *PowerTax / N-ABLE / Company Tax Kit*; and Moore Stephens's *Complete Tax Solutions*.
33. Market inquiries conducted with large companies who use income tax compliance software indicated that they did not consider other income tax compliance software products, such as those targeted at SMEs, to be a demand-side substitute. Large companies noted that the products targeted at SMEs do not offer the specialised functionality (e.g. consolidation functionality) or the level of automation required.
34. Similarly, in-house developed solutions (such as those based on Excel) were not considered by most large companies using income tax compliance software to offer the level of functionality required and, as they require substantial manual entry and do not have safeguards if information is entered incorrectly, they involve an unacceptable level of risk.
35. The ACCC's preliminary understanding is that there are some large companies that still use in-house developed solutions. However, the ACCC notes that substitution between in-house developed solutions and income tax compliance software products appears to be asymmetric. That is, a large company may substitute to income tax compliance software products from an in-house developed solution, but the converse is extremely rare. Market inquiries suggested that once large companies had switched to income tax compliance software products, there were significant costs and obstacles in switching back.

36. Market inquiries to date have also indicated that outsourcing income tax compliance activities to a professional advisor was not a demand-side substitute for large companies. This is because outsourcing was considered to be considerably more expensive. Market inquiries also indicated that outsourcing income tax compliance activities and the use of income tax compliance software are typically used at different steps in the tax compliance process. Specifically, tax compliance software for large companies is used in the earlier tax return preparation stages, while external professional advisors are typically employed at the final review stages.
37. The ACCC's preliminary view is that there is a separate product market for income tax compliance software to large companies.

FBT compliance software

38. From market inquiries conducted to date, the ACCC understands that the main customers in this market are companies with complex FBT compliance needs.
39. Among other things, 'complex FBT compliance needs' mean that there are a large number of employees that may each receive a sizeable number of benefits. Similarly, these companies tend to be customers of large accounting firms and have an in-house tax department or specialised tax manager.
40. Market inquiries to date have suggested that some companies only have three substitution possibilities for their FBT compliance needs — Ernst & Young's *FBT Organiser*; Thomson Reuters's *PowerTax FBT / FBT Simplifier / FBT Toolkit*; and the NTAA's *FBT Return Preparer*.
41. For some customers, market inquiries indicated that FBT compliance software cannot be substituted for in-house developed options, such as Excel. For others, FBT compliance software is a demand-side substitute for an in-house developed option.
42. Similar to income tax compliance software and in-house developed solutions, evidence from market inquiries suggested FBT compliance software and in-house developed solutions to be asymmetric demand-side substitutes.

The ACCC invites market participants to comment on possible substitution options

The ACCC invites further comments on:

- the substitution options for companies conducting their income tax compliance activities, and specifically, whether a 5% increase in the price of income tax compliance software would motivate companies to switch; and
- the substitution options for companies conducting their FBT compliance activities, and specifically, whether a 5% increase in the price of FBT compliance software would motivate companies to switch.

Market inquiries

43. On 6 July 2009, the ACCC commenced market inquiries regarding the proposed acquisition. A range of interested parties provided responses, including actual and potential competitors, customers and interested third parties.

Statement of issues

44. For the purposes of this Statement of Issues, the issues in this matter are divided into two categories, 'issues of concern' and 'issues that may raise concerns'.

Issues of concern

Competition for the supply of income tax compliance software to large companies

45. The ACCC's preliminary view is that the proposed acquisition is likely to substantially lessen competition in breach of section 50 of the Act in relation to the supply of income tax compliance software to large companies. The likely effect of the proposed acquisition is that the merged entity would have an increased ability to raise prices to customers, reduce the quality of its products and services, and/or delay development in its products and services.

Degree of rivalry between Thomson Reuters and Ernst & Young

46. From its market inquiries to date, the ACCC understands that Thomson Reuters and Ernst & Young are the two largest suppliers of income tax compliance software for large companies in Australia, and together hold a very substantial share of the national market for income tax compliance software for large companies.
47. Market inquiries indicated that Ernst & Young, with its *Tax Integrator* product, is Thomson Reuters's closest competitor for the supply of income tax compliance software to large companies. Evidence provided to the ACCC illustrated that most large companies wanting to switch from in-house developed solutions to income tax compliance software products choose either a Thomson Reuters's product or an Ernst & Young product.
48. Market inquiries to date suggested that some customers using Ernst & Young's *Tax Integrator* have switched to one of Thomson Reuters's products and vice versa. In addition, the ACCC received information that some customers had threatened to switch from Ernst & Young's *Tax Integrator* to a Thomson Reuters's product, and vice versa.
49. The proposed acquisition would therefore be likely to result in the removal of Thomson Reuters's closest competitor in this market.

Further information sought by the ACCC

The ACCC seeks further information and comments in relation to the nature and extent of competition between Thomson Reuters and Ernst & Young in relation to the supply of income tax compliance software to large companies, such as examples of customers switching or threatening to switch from one merger party to another.

Degree of rivalry between the merger parties and Moore Stephens

50. Market inquiries identified Moore Stephens as the only supplier of income tax compliance software for large companies in Australia, other than Thomson Reuters and Ernst & Young, with its *Complete Tax Solutions* product. The proposed acquisition would therefore result in a reduction in the number of competitors from three to two in this market.
51. Market inquiries indicated that Moore Stephens currently supplies a very small share of the market and is therefore not considered by the ACCC as likely to pose an effective competitive constraint on the merged entity post-acquisition. The ACCC is of the preliminary view that Moore Stephens is constrained from expanding its customer base.
52. The ACCC will further explore with customers the differences in functionality between the products supplied by the merger parties and the product supplied by Moore Stephens.

The possibility of new entry

53. At this stage, the ACCC considers that likely, timely and sufficient entry by a new player in response to a price increase by the merged firm is very low.
54. All products to date in the relevant market have been developed by large accounting firms — PwC, Deloitte / KPMG, Ernst & Young and Moore Stephens. The ACCC understands that product development requires a high level of tax expertise and a high level of IT expertise.
55. From market inquiries, the ACCC understands that it would take between 6 months and 3 years to develop a 'green fields' product and this is likely to cost in the order of \$3 million. More importantly, a new entrant is unlikely to generate a sufficient return on their investment given there are difficulties in attracting a 'critical mass' of customers. Further, the ACCC is of the preliminary view that customers are unlikely to sponsor new entry.
56. Evidence from potential entrants and existing suppliers of income tax compliance software products in other countries suggested that entry or expansion was unlikely to occur. The ACCC's preliminary understanding is that effective entry would only be possible through acquisition.
57. On the basis of market inquiries conducted to date, the ACCC therefore considers that the market is characterised by significant barriers to entry and expansion.

Further information sought by the ACCC

The ACCC seeks further information on:

- whether Moore Stephens is currently an effective competitor in the relevant market, including any relevant details on the relative functionality and usability of *Complete Tax Solutions*, compared with the income tax compliance software for large companies currently supplied by the merger parties;
- the extent to which Moore Stephens will be able to exercise an effective competitive constraint on the merged firm post-acquisition, including whether it will be limited in its ability to expand its existing customer base for *Complete Tax Solutions*;
- the height of barriers to entry, including the difficulties a company would face in developing a product and attracting a 'critical mass' of customers. Please also comment on whether customers would be likely to sponsor new entry in response to a price rise by the merged entity;
- the height of barriers to customers switching to a new income tax compliance software product, including the time and costs involved; and
- whether there are any likely candidates for entry, in light of the fact that all current income tax compliance software products were developed by accounting firms in Australia.

Issues that may raise concerns

Competition for the supply of FBT compliance software

58. The ACCC's preliminary view is that the proposed acquisition may raise substantial competition concerns in relation to the supply of FBT compliance software.
59. The ACCC notes that the proposed acquisition aggregates the two largest suppliers of FBT compliance software in Australia. The ACCC considers that the proposed merger could increase the merged firm's ability to raise prices for FBT compliance software.

Degree of rivalry between Thomson Reuters and Ernst & Young

60. From its market inquiries to date, the ACCC understands that Thomson Reuters and Ernst & Young are the two largest suppliers of FBT compliance software in Australia. The ACCC's preliminary view is that the proposed acquisition is likely to result in the removal of Thomson Reuters's closest competitor in this market.
61. Market inquiries indicated that Ernst & Young, with its *FBT Organiser* product, appears to be Thomson Reuters's closest competitor for the supply of FBT compliance software. However, the ACCC requires further detail with respect to customer switching or customers threatening to switch. Relevantly, the ACCC is of

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the view that if information is received that suggests there is switching or some customers have threatened to switch from one merger party to the other and vice versa, then there is likely to be a substantial lessening of competition in breach of section 50 of the Act in this market.

Further information sought by the ACCC

The ACCC seeks further information and comments in relation to the nature and extent of competition between Thomson Reuters and Ernst & Young in relation to the supply of FBT compliance software, such as examples of customers switching or threatening to switch from one merger party to another.

Degree of rivalry between the merger parties and other suppliers

62. Market inquiries identified NTAA as the only supplier of FBT compliance software for large companies in Australia, other than Thomson Reuters and Ernst & Young, with its *FBT Return Preparer* product. The proposed acquisition would therefore result in a reduction in the number of competitors from three to two in this market.
63. The ACCC will further explore with customers the differences in functionality between the products of the merger parties and the NTAA's product. The ACCC is not currently aware of other suppliers of FBT compliance software products.
64. On the basis of information obtained to date, the ACCC considers barriers to entry and expansion to be high for FBT compliance software for similar reasons to that noted above for income tax compliance software. However, the ACCC seeks further information on this issue from market participants.

Further information sought by the ACCC

The ACCC seeks further information and comments on the market for the supply of FBT compliance software. In particular, the ACCC seeks further information on:

- current market share estimates for the national market for the supply of FBT compliance software;
- whether NTAA is currently an effective competitor in the relevant market, including any relevant details on the relative functionality and usability of *FBT Return Preparer*, compared with the FBT compliance software currently supplied by the merger parties;
- the extent to which NTAA will be able to exercise an effective competitive constraint on the merged firm post-acquisition, including whether it will be limited;
- the height of barriers to entry, including the difficulties a company would face in developing a product and attracting a 'critical mass' of customers. Please also comment on the barriers customers would face in switching and whether customers are likely to sponsor new entry in response to a price rise by the merged entity;
- the height of barriers to customers switching to a new FBT compliance software

product, including the time and costs involved; and

- whether there are any likely candidates for entry.

ACCC's future steps

65. The ACCC will finalise its view on this matter after it considers market responses invited by this Statement of Issues.
66. The ACCC now seeks submissions from market participants on each of the issues identified in this Statement of Issues and on any other issue that may be relevant to the ACCC's assessment of this matter.
67. Submissions are to be received by the ACCC no later than 3 September 2009. The ACCC will consider the submissions received from the market and the merger parties in light of the issues identified above and will, in conjunction with information and submissions already provided by the parties, come to a final view as to the appropriate course of action to take to resolve any competition concerns that remain.
68. The ACCC intends to publicly announce its final view by 23 September 2009. However the anticipated timeline may change in line with the *Merger Review Process Guidelines*. A Public Competition Assessment for the purpose of explaining the ACCC's final view may be published following the ACCC's public announcement.