Mapping the Steps to Global VAT Management

How to Effectively and Strategically Manage Your Global VAT Position

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Introduction

Often when discussing Value Added Tax (VAT) management with U.S. multinationals, the question arises on how a U.S.-based business, with no particular knowledge or skills in the VAT arena, can start to effectively and strategically manage its global VAT position? It takes effort, commitment, and support from senior management to create the necessary control and reporting processes to achieve this, but the payback is potentially enormous as rates of VAT are generally more than double the average U.S. sales tax rates.

There are three primary reasons for U.S. multinationals to pay particular attention to VAT management. These are:

a. Tax can no longer be ignored or pushed to the sidelines in the post-Sarbanes-Oxley regulatory environment. In light of the very high rates applicable in the VAT world, the average global rate being around 18 percent, Sections 302 and 404 of the Sarbanes-Oxley Act have compelled many CFOs to examine how they can obtain a reasonable level of assurance that their overseas operations are in compliance with local VAT legislation *before* they put their signatures to a Sarbanes-Oxley attestation. This might seem a daunting task for a U.S.-based tax department that may be short on resources and even shorter on VAT expertise but there are steps that can be taken to minimize exposure.

b. Financial penalties can run into the hundreds of percent of the tax under-declared and interest rates are often compounded. Even non-SEC registrants should take steps to ensure accurate international VAT compliance if for no other reason than the draconian penalties and interest rates that commonly apply to erroneous declarations in the VAT world.

c. VAT savings almost invariably go straight to the bottom line, which can put quite a different perspective on the value of undertaking this type of work. One multinational that saved a modest $100,000 using a VAT planning mechanism expressed the view that, as they generally operated on a 10 percent profit margin, this saving represented the equivalent of adding $1 million to their revenue figure. Perhaps that type of thinking might assist tax managers in persuading senior management that VAT planning can be a valuable tool in enhancing overall profitability.

The answer to the VAT management question is that a measured, staged approach is required to ensure that the right infrastructure is created in the beginning to appropriately support future efforts. There are six separately identifiable steps, described later in this paper, that need to be climbed in the advance towards global VAT management, but we must first understand why it is necessary and desirable for U.S. multinationals to take on this task.

Step 1 – Make Somebody Responsible for VAT Globally

As with any project, your VAT Management program will need someone to drive and promote it within the company. The driver should be of sufficient seniority and in a position of influence to get things done. However, initially the success or failure of the project will depend heavily upon the active support of the Tax Director and the CFO. It has proved invaluable in past projects to ensure that the VAT Management Program is featured in the performance objectives of each person involved, as this tends to add focus to the project.

The driver does not need to be someone with any specific background in VAT, but they should have at least a basic grasp of sales tax concepts. Past experience has shown that many of the more successful drivers of these projects tend to be found in the Finance function rather than the Tax area, perhaps because they generally have a wider view of the company's operations. The most important quality required by the driver is networking skills, which leads us to step 2.

Step 2 – Build a VAT Network

It is practically impossible for a single person to effectively manage a multinational company's VAT affairs, so it is essential that a VAT Network be developed covering all the key countries where the company does business. The best way to do this is for the driver to contact the CFO for each of the territories/regions concerned and ask them to nominate a VAT Coordinator for each key territory. The VAT Coordinator will be responsible for reporting into the VAT Network in respect of their own territory and the driver will be responsible for the overall global VAT picture. By breaking down geographic responsibilities in this way, the driver should not become overwhelmed with the size of the task.

Once the network is in place, regular communication should be established. These communications could include monthly conference calls for team discussion on VAT developments in their respective countries, as well as issues and opportunities that have arisen and any concerns they might have over other VAT matters. It is surprising how often issues or planning opportunities cropping up in one country can be equally applicable to other territories, thus leveraging the value of the network.

Step 3 – Understand Your VAT Profile

Before making real progress with getting your company's VAT position into shape, you need to know where things stand today. To do this, it is necessary for the VAT Network to devote some up-front time to identifying the company's VAT profile or footprint. Whether or not you are planning to deal with any VAT issues in-house, your advisers will need this information in order to help you, making it a good time investment either way. It is important to note that a great deal of the data required in this exercise will not come from your finance or tax colleagues alone. It will be necessary to include international sales, marketing, business development, and logistics personnel in establishing the true fact patterns and there may still be others to take into account, depending on the structure of the business concerned.

So what information do you need to fill out the company's VAT profile? The following data would be sufficient to create a basic profile:

Understand the Businesses

The company's overseas operations may not be run in the same way or sell the same products or services as the U.S. parent, so it is important to understand what each business actually does. In the VAT world, varying tax rates can apply to different types of goods and services. Additionally, some complex jurisdictional rules have a significant bearing on the taxation of international services. Therefore, as a first step, gather as much information as possible about the overseas operations so that you have the complete understanding of the international business. In particular, it is important to identify for each company:

- Which products and services are supplied and which rate of VAT applies to each of those supplies.
- Details of any cross-border sales and, if any, which are the destination countries.
- Details of any cross-border purchases and, if any, which are the origin countries.

VAT Registrations

In which countries is the company registered for VAT? Are there multiple VAT registrations in any of those countries? Collect details of each registration including the VAT registration numbers and the date on which each registration came into effect. Also, some countries permit businesses with multiple registrations to form VAT groups. You should check to see if any VAT groups exist and, if so, which companies are members of such groups. These details will give you a geographical picture of the company's VAT profile so that you can pinpoint in which territories you should be focusing your efforts.

A planning point here is that if you have multiple companies that are operating in a country where VAT groups are permitted, you should look very carefully at whether any groups have actually been formed. There are several benefits for companies that are grouped together, including improved cash flow, the elimination of certain invoicing requirements and reduced filing requirements.

VAT Cash Flow

To establish the company's VAT cash flow, you need to identify the total VAT that each company has billed to its customers and the total VAT that suppliers have charged to each company. It does not matter whether any of this VAT was at some stage reclaimed or off-set, just include all VAT on sales and all VAT on purchases. When you add together both sets of values for a given period, say 12 months, you arrive at the company's VAT cash flow value. Quantifying the company's VAT cash flow is important for a number of reasons.

- First, you will most likely be surprised at how high the numbers are. This is simply a function of the generally high rates that apply in the VAT world. For example, within the European Union, there is no standard rate of VAT lower than 15 percent and it can be as high as 25 percent. The global average VAT rate of 18 percent is in stark contrast to U.S. sales tax rates, which average around 8.5 percent.

- Cash flow management is one of the critical areas of overall VAT management and planning, so quantifying the values involved is a basic discipline that should be done regularly. By way of illustration on this point, when this exercise was carried out by one U.S. multinational in the consumer goods sector, it found that it had $3 billion in VAT cash flow over the previous year and that this cash had gone completely unmanaged. The cost of this oversight was significant and VAT assumed a far higher priority in that organization in the future.

- Without identifying the quantum of the company's VAT cash flow, it is difficult to properly prioritize VAT in terms of the effort that should be allocated to its management and planning. This is the case both in respect of managing company assets and in considering the actual and potential impacts that VAT may have on the company for Sarbanes-Oxley purposes. For example, if this exercise shows that VAT represents more than 10 percent of a company's total cash flow, then Tax Directors and CFO's should be looking very closely at the processes and controls they have in place around this tax.

VAT Return Filings

Check whether each VAT registered company has filed all of its VAT returns and done so on time (there are penalties for late filings). If any of the returns are outstanding or there is a history of late filings, this should prompt further investigation.

In addition (and for E.U.-based businesses only), check whether each company that trades on an intra-E.U. basis has filed its Intrastat and European Sales Listing returns in a timely manner. These documents are statistical returns that are often overlooked but their submission is mandatory and compliance failures in this area are likely to negatively impact the company.

Audit History

Establish whether each of the registered companies has been audited for VAT by the local tax authorities and, if so, what was the outcome? Was any additional tax assessed as a result of the audit? If so, why and has that problem now been rectified?

Regional VAT Profiles

It is likely that some of the company's overseas operations will have responsibility for servicing more than one country so they will, in turn, also have an international footprint which needs to be managed in the same way as the U.S. parent company is managed.

Step 4 – Check Your VAT Position in Countries Where You Are Not Registered

A multinational company may run into all sorts of problems with its overseas VAT positions, but none is potentially more serious than failing to register for VAT in a country where it is doing business. It is bad enough for a company to fail to properly account for VAT in a country where it is registered, but failing to even register in the first place is significantly more serious and could have substantial consequences when the position is discovered. For instance:

- The company's VAT registration will be backdated and the company may have to fund the back-taxes itself;
- There will be penalties payable for failing to register and interest (often at high and compounded rates) will be payable on the unpaid tax;
- Recovery of VAT on the company's purchases may be blocked, depending on the country's rules in respect of time limits applying to VAT reclaims;
- The company will start its VAT registration with a poor compliance history, which will mean additional attention from the tax authority in the future; and
- If there is any suggestion that the company knew it should have been registered but failed to do so, the tax authorities may consider bringing fraud charges against the company.

So where should you look to identify potential VAT registration failures? This is a difficult question to answer without knowing the company's VAT profile, but there are some instances that could indicate that a VAT registration might be appropriate. From experience, the most common problem area is call-off and consignment stock being held in countries where the company does not otherwise have any operation. For example, in the high tech sector it is common for companies to hold stocks of spare parts in locations that are geographically close to their customers. While a warehouse keeper or logistics company often physically manages these stocks, they actually belong to the company and so, when they are supplied to the customer in the foreign country, the company is deemed to be making a local supply that is subject to local VAT.

Supply-and-install contracts are another area that causes problems. Many countries require a supplier to register for VAT in the country where the installation takes place, but this is often overlooked by companies that have employees on-site for only a few weeks and who then return to their home countries. It should be borne in mind, however, that the liability to register does not disappear just because the installation personnel are no longer on-site and to ignore this position would be storing up problems for later.

Toll manufacturing also creates problems in this area if the goods are passed cross-border for any of the manufacturing stages. Under these arrangements, the company remains in ownership of the goods as they are moved and can be deemed an importer (and, possibly, exporter) of the goods, so triggering a VAT registration liability.

One final tip on this point is to check the shipping terms (FOB, CIF, EXW, DDP, etc.) that are commonly used for cross-border deliveries. While the shipping terms are not necessarily determinative, they are at least indicative of possible problems. For example, the shipping terms DDU and DDP (delivered duty unpaid and delivered duty paid respectively) indicate that the supplier may be the importer of the goods being supplied internationally. As an importer, there may be a VAT registration issue to deal with.

Step 5 – Get Some VAT Training

While it is not essential for all members of the VAT Network to have an in-depth knowledge of the technicalities of VAT, all should have at least an understanding of the basics. There are a great many misconceptions about VAT and how it works and these are often perpetuated as outgoing members of staff hand on to their successors. Most of these misconceptions arise through the assumption that VAT works in broadly the same way as U.S. sales taxes. While it is possible to draw many parallels between the two, there are also many fundamental differences. For this reason, specialists in the field should carry out VAT training and, if this means looking outside the organization for appropriate resources, so be it.

As a general guide, the following subject matter should form the agenda for a basic VAT training course:

- Taxable person – who should account for VAT?
- Supplies – identifying different types of supply for VAT purposes
- Nature of supply – differentiating between goods and services
- Place of supply (situs) rules for goods and services – identifying the correct taxing jurisdiction and accounting for VAT on international supplies
- Time of supply – rules applicable in identifying tax points
- Value of supply – valuation rules
- VAT liability – which VAT rates apply to which types of supply?
- Deduction of VAT – rules in respect of recovering VAT on charged to the company on its purchases
- Overseas VAT refunds – many countries allow foreign businesses that are not established within their territory to reclaim VAT they incur locally

Depending on the type and international dimensions of the business, you might want to add agenda items related to trading in the E.U. (which has a plethora of specific issues). You could also consider adding some industry-specific material. For example, sectors such as financial services, electronic commerce (internet supplies), real estate, healthcare, education, and charities all have a great many VAT issues that are specific to them and an element of focused training could be useful.

One other point to bear in mind is that VAT is not simply a Finance or Tax department issue. Any training in the subject should also be open to sales, marketing, and logistics personnel, as their actions can often impact the company's VAT profile.

Step 6 – Develop a Global VAT Strategy

There are two key objectives to be addressed in developing a global VAT strategy:

Mitigate VAT Risks

The single most positive thing that the VAT Network can achieve is to create ingrained VAT awareness across the business. The problem is that VAT has so many touch points on a multinational company that it is next to impossible for the network to keep an eye on every instance. What is needed is dozens or hundreds of pairs of eyes looking out for possible VAT issues and then bringing them to the attention of the VAT Network. Of course, this will take time and effort to achieve, but in the long run will be an effort well worth making.

The most effective way of generating VAT awareness is to plan regular communications with all departments of the company, thus keeping the subject in the front of their minds. Quarterly newsletters can be effective and the content for these can be derived from the VAT Network discussions and from other sources such as tax publications, online tax sites, and from other newsletters. Most of the big accounting firms produce some form of regular VAT briefings and are usually happy to include both clients and non-clients on their mailing lists. Subscriptions are normally free, so there is no excuse for not taking advantage of the opportunity.

You should also try to keep VAT awareness alive by placing it on the agenda of departmental meetings (not just the Finance and Tax departmental meetings, but meeting throughout the company to discuss VAT with a wider audience). You should ensure that internal auditors have VAT on their checklists and that external auditors cover VAT as part of the annual audit. From long experience, it is often the case that issues get taken more seriously if people within the organization know that there is external scrutiny, so including VAT as an annual audit item can raise the profile of VAT significantly. In these post-Sarbanes times, you may very well find that the auditors will want to include VAT in their work anyway.

Ultimately, the main way of mitigating VAT risks is to maintain an informed vigilance on a regular basis. The personnel who form the VAT Network should have VAT management included in their performance objectives and sufficient time should be made available for them to deal with this very complex tax. Handling network activities, attending VAT training, writing newsletters, and attending internal meetings should all be accommodated in their work plans.

Maximize VAT Opportunities

There are hundreds, if not thousands, of VAT planning ideas in the global marketplace, some of which are geography-specific, some are industry-specific, and some are generally applicable. It stands to reason that most multinational companies should be able to benefit from at least some of these, whether a simple, compliance-focused mechanism or a big-ticket restructuring idea that could save millions of dollars.

The main repository of these ideas, unsurprisingly, is the big accounting and consulting firms. Each of them has significant VAT specialist resources stationed all over the world and, if you ask, will be delighted to walk you through which planning ideas might be most appropriate for your company. The VAT profile that you have constructed will come in handy helping them identify the most appropriate opportunities for your particular circumstances. A note of caution, before embarking on any VAT planning exercise, it is very important that you fully appreciate the risks involved and the cost-benefit of the individual planning mechanisms. As with any tax planning, some ideas are more risky than others, so be sure to ask your adviser to allocate each scheme a high, medium, or low risk categorization. In this case, "risk" means not only whether or not the scheme will work for your organization but also the likelihood of the scheme being challenged (whether successfully or not) by the local tax authorities. On the question of the cost-benefit analysis, bear in mind that projected savings may not materialize to the extent that you and your advisers had anticipated and that there may be cost over-runs to contend with.

It is important to note that some VAT planning ideas have multi-country or even regional application, so the VAT Network should discuss any ideas that come their way in order to leverage the planning to its fullest extent across several territories. For this reason, it should be one of the goals of the VAT Network to meet regularly with their local advisers in order to keep abreast of the latest planning ideas.

Step 7 – Implement Automation Technology

More companies are turning to technology solutions to automate many of their VAT and other indirect tax processes, in doing so, enhances the certainty with which they are able to handle their international transaction tax affairs. The most common issue that these companies face is that they have historically relied upon their accounting data input staff to make most of the VAT taxability decisions such as whether VAT should be added to a sales invoice or deductible on a purchase invoice. However, these staff members are rarely VAT experts and so errors and inconsistencies can arise.

What many companies seek and find in tax automation technology solutions is the assurance that third party subject matter experts are, for all intents and purposes, making taxability decisions for them and those decisions are more reliable and consistent than those that the company itself could make. Another reason that tax automation has become more popular in recent years is that the software providers in this space have invested heavily in understanding the needs of businesses and in making their software more flexible, user-friendly, and relevant to international businesses.

We should not forget, of course, the influence that Sarbanes-Oxley has had on a business's decision to automate their tax processes. With the added scrutiny that will apply to all aspects of a company's accounting practices, many CFO's are seeking assurances that appropriate controls are in place across the business's accounting functions and VAT (in particular) is one area that often gets overlooked. For these companies, automating the VAT function could provide the risk mitigation and assurance that is required.

These solutions can also assist the VAT Network in communicating globally by referencing processes that are understood by all. In other words, if a company's worldwide enterprises are all running on a common VAT platform, the VAT Network members are able to address VAT issues by reference to that platform, by-passing the majority of local or regional differences in their understanding of how the tax impacts (or should impact) their organization.

Summary

There are still many U.S. multinational companies that shy away from managing their global VAT positions, seeing this tax as something foreign and best left to their overseas colleagues to deal with. However, with a little time, effort, technology adoption, and internal cooperation, VAT can be effectively and strategically managed from a central U.S. location – adding real value to the company's bottom line and providing the assurance that CFO's will be seeking when it comes time for them to sign Sarbanes-Oxley 404 attestations.

About Vertex

Founded in 1978, Vertex Inc. is the leading provider of corporate tax software and services to automate, integrate, streamline or outsource tax processes for companies of all sizes, from small to medium-sized businesses to global multinationals. Vertex provides solutions for all tax types with industry-specific solutions for retail, communications, hospitality and leasing industries.

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