7 Reasons to add a Tax Engine for VAT/GST Determination

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Management Summary

In these times of constant change in both business operations and legislation there are a number of arguments why multinational businesses should at least consider the implementation of a tax engine;

1. It takes away the burden and costs of continuous in-house tax research as this is outsourced to the provider;
2. Improved VAT/GST determination accuracy, compared to native ERP more relevant data elements are part of the equation;
3. Less IT involvement needed to implement VAT/GST changes as this can be managed by VAT/GST specialists themselves;
4. Improved and consistent tax coding in the AP process;
5. Adequate real-time reporting as a result of first-time right VAT/GST determination;
6. Improved VAT/GST controls at a central level, a more agile tax organisation due to shorter lead times and instant scalability;
7. Overall reduced costs for global VAT/GST management.

The end-to-end VAT/GST process in multinational businesses becomes more efficient, agile and scalable as a result of the implementation of a tax engine. Constant and consistent tax coding first results in less invoicing discussions and payment delays with both customers and vendors but also in less discussions with tax authorities in case of audits or queries.

The key advantages of a tax engine over native ERP or an Add-in solution are (i) with an Add-on the company still need own resources for research and implementation of VAT/GST content, (ii) IT resources are still required for maintenance of the VAT/GST rules in ERP or the Add-on, (iii) a tax engine can be connected to multiple ERP's while ERP configuration or Add-on implementation and maintenance needs to be done per instance and (iv) a tax engine is scalable to Cloud while VAT/GST rules in ERP or an Add-on are embedded in the system.

Introduction

The tax function in today's multinational businesses must accommodate nearly constant changes that affect VAT/GST determination – not just the ongoing regulatory changes, but business changes including geographic expansion, mergers & acquisitions, new business units, new ERP systems, new sales channels like e-commerce, new procurement platforms, and new product offerings with complex taxability.

The manual process of tax research and updating every transactional finance system can be a significant cause of VAT/GST error, and a strain on in-house tax and IT resources. Even when the ERP and other financial systems are updated with the latest VAT/GST changes, the native tax functionality in these systems often doesn't meet the VAT/GST determination needs of a complex multinational organisation, leaving them exposed at audit time.

Many successful multinational companies have found that integrating a 3rd party tax engine to their ERP and other transactional finance systems significantly improves tax accuracy and the overall tax department agility.

Many successful multinationals have found that integrating a 3rd party tax engine to their ERP and transactional finance systems significantly improves VAT/GST accuracy and overall tax department agility. A tax engine determines VAT/GST on every sales or purchase transaction in real time as it's processed. The latest VAT/GST rules, rates, and taxability logic are maintained in the tax engine, outside the ERP or other financial system. This centralises global VAT/GST management within a single system which can be integrated to every transactional finance system across the enterprise. The discussion below lays out 7 reasons for adding a tax engine to manage VAT/GST determination.

1. Eliminate in-house VAT/GST research

Maintaining VAT/GST research in-house can be a significant burden for a multinational organisation. ERP and e- commerce systems don't provide content for global VAT/GST rates or restricted input VAT/GST deductibility rules, it must be continually researched by the tax department. Each new legislative change in the indirect tax system in every country where the company does business brings new risk that the company's VAT/GST determination has become out-of-date exposing the business to discussions with customers due to incorrect invoicing, discussions with vendors due to delays in invoice processing and late payments and last but not least tax assessment at audit.

Additionally, each significant legislative event typically requires a costly tax advisory engagement for advice on the new VAT/GST conditioning requirements so that all ERP and e-commerce systems can be updated in time for accurate VAT/GST determination.

Adding a tax engine to the procurement, ERP, and e-commerce systems shifts that burden to the tax engine provider since the content is managed in the tax engine and not in the ERP/e-commerce system. This eliminates the need for in-house research and costly external advice, freeing up tax and IT department resources for more valuable work.

Since the VAT/GST content is maintained in a single centralised tax engine and updated continually by the tax engine provider, this means every transactional finance system connected to the tax engine is leveraging the latest VAT/GST place of supply rules, rates, and deductibility requirements. It ensures companies can adapt easily to otherwise costly VAT/GST developments such as Brexit, implementation of GCC countries, and EU VAT reform, for example.

2. Improve VAT/GST determination accuracy

Even those companies who have adequate resources to maintain VAT/GST research and continually update every system can still incur penalties for incorrect VAT/GST determination when their transactional finance systems simply cannot accommodate complex calculations. Since a tax engine has been designed for the sole purpose of VAT/GST determination, the capabilities are more robust than the native VAT/GST determination in ERPs and other financial systems. An ERP/e-commerce system typically makes a VAT/GST decision based on a few pieces of data for each transaction e.g., billing country, vendor country, ship-to country, invoice date. A tax engine can consider (and prioritise) 100+ data elements that are passed from the ERP/e-commerce system for VAT/GST determination on a transaction. For example, detailed conditions can be created that are specific for exceptional VAT/GST treatments provided by vendors, or non-standard sales transactions. These can be triggered in a tax engine by custom rules specific to f.e. a given vendor, invoice number, or purchase / sales order type or number.

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Standard VAT/GST rules and content can also only get a business to a certain level of compliance in coding the conditions for accurate tax decisioning. Usually, businesses will have to comply and accommodate non- standard VAT/GST outcomes that are unique to their businesses or their business partners.

+ For example, in procurement, suppliers may be authorised to apply non-standard VAT rates and taxpayers may obtain permission from tax authorities to apply VAT simplifications in their supply chains.
+ Another example is the use of export licenses by customers allowing supplies to them to be zero rated until a customer specific threshold has been reached.

Often businesses will find that key data elements within their ERP and other systems are misleading for purposes of VAT/GST calculation.

+ For example, a business may configure its selling Incoterms to align with revenue recognition or insurance policies, rather than as an accurate reflection of who is acting as Importer of Record in a given VAT transaction.

A 3rd party tax engine provides an intuitive framework for tailored rules to be created and maintained by users in the tax function for bespoke scenarios. The accuracy of these tailored rules can be tested as scenarios before being put into production. This enables the 3rd party tax engine to reflect the individuality of VAT/GST policies and treatments from one business to another.

3. Accommodate VAT/GST changes without an IT project

Using native VAT/GST functionality in the procurement, ERP, or e-commerce systems requires the tax department to manually input and map each VAT/GST change to materials or condition records within the system. Global VAT/GST rates, place of supply, VAT coding, and deductibility are not provided in an ERP system so this must be configured individually by each business (customisation of ERP), and each ongoing change to VAT/GST rules and rates must be manually updated in every transactional system and for all relevant condition records in the system. In addition, any new ERP systems must be configured and maintained separately. This requires significant effort and teamwork between tax department and IT resources on an ongoing basis. A complex systems landscape will naturally multiply the amount of IT work necessary to update for VAT/GST changes and remain compliant. If IT activities have been offshored, working in different time zones and communication issues may add to the challenges.

Using native system functionality to manage global VAT/GST nearly guarantees a need for a constant process of re- design, re-configuration, testing and stabilising every system to stay abreast of major developments:

+ VAT/GST changes like the recent changes for MOSS, the VAT quick fixes and the implementation of VAT/GST systems in the Gulf States, India, and Malaysia
+ Business changes like new products, new ERPs, sales expansion, new business or supply chain models, M&A activity, etc.

In addition, when VAT/GST is configured in the ERP or other system, it is particular and bespoke to individual business facts, often to those business facts as they existed at the first implementation. Each future global VAT/GST development will require the business to re-configure VAT/GST decisions in each system.

Using a 3rd party tax engine can "future-proof" a company's VAT/GST management.

Using a 3rd party tax engine eliminates the need for IT resources to manually update each transactional finance system and can "future-proof" a company's VAT/GST management. Since VAT/GST content is maintained outside the financial system, updated in one place, and leveraged across all systems, there's no need for multiple manual updates to accommodate every change.

4. Ensure a reliable, repeatable AP process

Adding a tax engine to your procurement, ERP, and e-commerce systems automates processes to ensure a more reliable and repeatable accounts payable (AP) process. It replaces "user trust" with "system certainty".

+ **At the point of requisition,** a tax engine provides a real-time calculation of the landed-cost including applicable VAT/GST, taking into account the rate of VAT/GST, the local rules for VAT/GST deduction, any deductibility requirements individual to the company, as well as the apportionment methodology and recovery-rate that apply for partially exempt businesses. Therefore, budget holders can understand budget implications of purchases as they create requisitions.
+ **At the invoice posting stage,** a tax engine based on VAT/GST logic replaces manual user-defined VAT/GST coding. This varies based on the user's understanding of whether the vendor has charged the appropriate VAT/GST rate, whether the business is entitled to fully or only partially deduct the VAT/GST, whether the business needs to self-account VAT on the reverse-charge basis. This also varies based on the amount of processing time an AP clerk is granted for processing an invoice and the understanding of the many reasons why there is no VAT/GST on an invoice. And all of this knowing that VAT/GST is not part of the 3-way match. The tax engine replaces all these human decisions with reliable rules-based automation for improved accuracy and reduced risk. Automating these decisions also significantly lowers training costs for VAT/GST processes.

A tax engine also ensures consistency and standardisation of tax treatment when the AP function is located in a different region, and perhaps speaking a different language than the tax department, making it difficult to ensure that changing VAT/GST requirements are understood by AP users prior to posting.

5. Adequate real-time reporting

With continual movement toward real-time reporting, businesses are losing the buffer of time to run the month-end review process to fix VAT/GST determination errors prior to filing. Accurate VAT/GST determination at the time of the transaction becomes the first step toward streamlining and improving compliance.

In the traditional VAT/GST compliance model, measuring the quality of VAT/GST determination in reportable transactions is often part of the pre-month-end processes. Exception reports can be executed against VAT/GST transactions to detect anomalies and ensure these are corrected prior to finalising the periodic VAT/GST filing.

With real-time reporting, days and weeks may have passed between the real-time data filing to the tax authorities and the month-end process to identify transactional errors. This gives tax administrations much more scope to raise individual transactional queries that can develop into comprehensive VAT/GST inspections. There has never been more pressure for businesses to obtain accurate VAT/GST determination the first time, in real time.

6. Improve tax department control, agility, and scalability

A tax engine improves tax department control because the system is operated and maintained by VAT/GST professionals instead of the IT staff.

+ New VAT/GST requirements can be quickly translated to VAT/GST conditions by the tax department users, putting control in the hands of VAT/GST users rather than ERP-language developers.
+ The tax engine also ensures standardized and consistent VAT/GST treatment across all systems with centralised visibility.

With a 3rd party tax engine, the tax function can respond to business growth opportunities with greater agility, speed, and confidence.

+ When faced with a VAT/GST change or new product line or new sales channel, the tax department won't be the one to hit the brakes in order to do VAT/GST research and kick off IT projects to accommodate the changes in every ERP and e-commerce system (or create a workaround). Tax professionals can immediately solve the issue within the tax department.

A tax engine gives back control to the tax department and ensures scalability for business growth.

Finally, a central tax engine makes VAT/GST determination easily ***scalable*** to keep tax moving at the speed of global business.

+ As new ERPs and financial systems are introduced by acquisitions, there's no need to verify, create or maintain individual VAT conditions or customisations for each new platform as companies simply connect the new platform(s) to the existing tax engine.
+ When the business expands into new markets or new product offerings, the tax department can simply add VAT/GST content for new products or markets.
+ In 10-15 years, when the company requires a new ERP system, there will be no need to start coding VAT/GST configurations from scratch or take the risk of copying old settings to the new environment.
+ The company will simply remove the tax engine connector from the old ERP system and add a connector to the new ERP system. All the configurations from the last 10-15 years that reflect the company's 'VAT/GST personality' live on in the new ERP system.
+ Multinationals doing business in the U.S. almost certainly employ a tax engine to manage sales and use tax determination across the 10,000+ taxing jurisdictions. Applying that same tax engine for VAT/GST across Europe enables the tax department to maximise the return on that investment, lowering the cost of global indirect tax determination across the enterprise. The ongoing maintenance of the tax engine for the U.S. can be leveraged to maintain the global VAT/GST solution. For example, the U.S. product portfolio and GL mappings maintained in a tax engine for calculating U.S. taxes apply equally to the global market. In addition, a single global tax engine will almost certainly improve central visibility, control and management reporting.

7. Reduce the cost of global VAT/GST management

Implementing a central tax engine provides a reduced total cost of ownership (TCO) over time when compared to native ERP VAT/GST management. The cost of a 3rd party tax engine is significantly less than the cost of a typical ERP implementation for VAT/GST plus the subsequent VAT/GST research and re-configuration for every VAT/GST change and business change over the years, not to mention the costs involved in a new ERP upgrade.

The cost of managing VAT/GST in the ERP or other system includes internal resources and consulting fees for:

+ VAT/GST research (including ongoing costs)
+ System configuration for every VAT/GST change and every business change (ongoing costs)
+ Complete re-creation of VAT/GST decisioning when a new system is implemented

Costs to manage VAT/GST using a 3rd party tax engine includes external fees for:

+ Tax engine implementation and configuration (one-time cost)
+ Connectors for additional ERP, e-commerce, procurement systems (one-time cost)
+ Tax engine license fee, which includes VAT/GST content updates (annual cost)

While a tax engine will add an annual license fee, that cost is typically far less than the combined cost of tax, IT, and outside consultants required for native ERP VAT/GST management. This is the result of a 3rd party tax engine provider being able to leverage development and research costs across their client base.

A New Paradigm for VAT/GST Determination

The tax department in today's multinational business faces dual challenges: the challenge of constant and increasing internal and external change introducing risk at every turn, and concurrently, the challenge of supporting exploding business growth opportunity. As a result, a new paradigm is required. A shift from managing VAT/GST determination within each transactional finance system to managing it in a single, centralised global tax engine can be the solution to reduce risk and provide the agility and scalability needed to support business growth.

About the Authors

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Donal Colbert leads the Vertex Consulting practice in Europe which advises alliance partners and customers on how to successfully implement and operate Vertex solutions to simplify the complexities of European VAT requirements. The Practice has more than 30 years' experience in operating tax technology for global VAT/GST determination and compliance in multinational companies. Donal has worked in indirect tax for more than 20 years: consulting at Meridian and PwC, and in-house at Toyota, EMC, and Dell Corporation.

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Peter Boerhof is the VAT Director for Vertex. In his role he provides insight and thought leadership regarding the impact of tax regulations, policy, enforcement and emerging technology trends in global tax. Peter has extensive experience in international transactions, business restructuring, tax process optimization and tax automation. Prior to joining Vertex, Peter was responsible for leading the indirect tax function at AkzoNobel. He holds an MBA from Rotterdam School of Management and a masters in tax law from the University of Groningen.

About Vertex

Vertex Inc., has been a leading provider of tax technology and services, enabling companies of all sizes to realize the full strategic potential of the tax function by automating and integrating tax processes, while leveraging advanced and predictive analytics of tax data. Vertex provides cloud-based, on-premise, and hosted solutions that can be tailored to specific industries for every major line of tax, including income, sales and consumer use, value added and payroll. Headquartered in Pennsylvania, Vertex is a privately held company that employs over 900 professionals and serves companies across the globe.