

White paper

Global indirect
**PROCUREMENT
AND TAX**
landscape



Summary

VAT compliance challenges have hampered procurement and accounts payable (AP) processes for decades. Today, the challenges caused by those impediments are rapidly increasing as global tax authorities embrace digital tax reporting requirements and overhaul existing rules to enable the real-time sharing of compliance data. As procurement teams and finance functions increase their strategic contributions through digital transformation, they have a unique opportunity to integrate advanced tax technology into their platforms. This integration can limit compliance risks while helping procurement and accounts payable groups make their activities as efficient as possible.

Procurement's global indirect tax challenges (and opportunities) increase

Getting VAT right the first time, amid procurement and regulatory disruptions

The more things change, the more things stay the same.

That old saying vividly describes the current VAT/GST challenges procurement teams and accounts payable teams confront throughout Europe and other regions globally – even while procurement processes and indirect tax rules and rates undergo transformations.

As recently as a decade ago, most European organizations operated the procure-to-pay (P2P) cycle as a labor-intensive process. The exceedingly manual nature of accounts payable – entering data from paper invoices into enterprise resource planning (ERP) systems, for example – resulted in delays and errors that encumbered VAT compliance activities while calling out for greater efficiency.

“VAT accuracy has always been a challenge in procurement and the accounts payable process,” notes Vertex Consulting EU Practice Leader Donal Colbert. “When invoice posting was a manual process, it meant that tax professionals had to trust the person who posted the invoice in the system. When you’re relying on trust while several complicating factors exist, ensuring the accuracy of VAT determination can be extremely challenging.”

Colbert is quick to emphasize that procurement processes and technologies have made tremendous improvements in the past two decades, with particularly impressive digital tools and capabilities emerging in the past couple of years. Yet, numerous indirect tax risks and challenges endure throughout P2P processes due to a combination of internal and external obstacles. The primary external obstacle are the sweeping and widespread changes to indirect tax policies and related compliance requirements tax authorities are enacting around the world. “Governments’ demand for more rapid and frequent filing continues to put pressure on businesses to get VAT correct from the outset,” asserts a Bulletin for International Taxation article co-authored by Vertex Product Owner Todd Cameron and other tax experts.¹

Getting VAT right the first time requires tax and procurement groups to:

- Recognize several long-standing indirect tax challenges in the P2P process
- Maintain an awareness of current and looming VAT/GST rules changes that affect procurement activities
- Pinpoint where the largest VAT compliance risks exist in the P2P process
- Understand how better collaboration and technology integration between tax and procurement mitigates those risks

1. “Technology-Enabled Tax Compliance,” *Bulletin for International Taxation*, October 2020: <https://www.ibfd.org/IBFD-Products/Bulletin-International-Taxation-Special-Issue-Technology-Key-Enabler-Tax>.



Procurement and tax teams should address VAT compliance risks in a collaborative fashion, Colbert notes. “Under VAT rules, it’s generally the vendor’s responsibility to issue a tax-compliant invoice,” he continues. “While that responsibility falls on the shoulders of the vendor, the VAT law specifies that VAT cannot be deducted on the basis of incorrect or invalid VAT invoices, many of the consequences of VAT compliance errors in the procurement process seem to fall initially on the shoulders of the purchaser. It’s often the purchaser who pays the price for the vendor’s error and incurs significant VAT penalties.” It’s worth keeping in mind that even very small errors that go undetected while being repeated over a lengthy period of time can ultimately snowball into serious monetary penalties.

Traditional sources of procurement inefficiencies

While more companies are putting advanced procurement platforms in place, legacy challenges linger. These issues should be identified and addressed if procurement and AP teams are to optimize the returns on their technology and process improvement investments.

Vertex Consultant Adam Runnalls says it is important for procurement professionals to understand that the compliance challenges surrounding VAT transactions can be significant. “In general, procurement is difficult from a tax perspective,” he explains. “That’s especially the case with indirect spend. Whereas direct spend tends to consist of a finite number of components on a daily or monthly basis so that tax requirements become straightforward over time, indirect spend involves many employees buying literally anything you can think of – tables, chairs, accounting services, car leases, etc. Direct spend, from a tax perspective, involves buying component X that is subject to a consistent rate of tax in a particular country. Indirect spend involves all of your people buying stuff globally with a multitude of possible tax rates.”

In a previous role as a tax technologist in a global manufacturing company, Runnalls and his colleagues developed a robust regression testing process to help ensure the tax compliance of all direct spending. “When it came to our indirect spending, we couldn’t do that sort of testing,” he adds. “The permutations of countries, commodities, and services involved in our purchases made it impossible to create a test script to give us comfort from a tax compliance perspective.”

Up until the early 2000s or so, the highly manual nature of procurement and AP processes also gave tax teams substantial discomfort. To perform work widely regarded as a volume-and-scale operation as cost-efficiently as possible, organizations typically assigned less experienced, entry-level professionals to those roles, especially the work involving invoice processing.



Original hard-copy invoices might take four days to arrive in the mail and then linger for another few days on someone's desk before being recorded by an AP clerk. Some invoices were lost in transit, necessitating their cancellation and reissuance. Delays and uncertainty increased the probability of duplicate invoice-postings and other errors, as did the required manual data entry. The high number of entry-level roles also resulted in higher levels of staff turnover on many AP teams, which further increased the risk of processing errors.

To reduce costs, larger organizations centralized AP operations. Other companies outsourced those operations to external providers in regions with lower labor costs, a trend that remains relatively widespread today. While those workforce decisions yielded cost-savings, they also gave rise to issues that jeopardized proper VAT determinations and calculations on procurement transactions. Common challenges included:

A lack of general tax knowledge: While entry-level procurement and AP professionals stepped into their roles with some accounting and/or data processing skills, they rarely possessed much, if any, multi-regional background VAT knowledge. This needed to be learned on the job.

A lack of country-specific VAT knowledge and language proficiency: A clerk based in a Polish shared services center, for example, may or may not have sufficient knowledge of how Greek VAT should be accounted for by a Greek company. Regardless of whether the AP team is in-house or outsourced, AP professionals rarely possess the combination of tax expertise and language fluency required to research the regulations and country-specific VAT requirements across Europe, notes Colbert. "While many tax departments provided foundational VAT training to AP teams," he adds, "that training could not address all of the unique VAT invoicing issues that can arise over the course of time." The high turnover rates that AP groups often experience also weakened the effectiveness of tax training.

Time constraints: Colbert also notes that tax teams sometimes create country-by-country "cheat sheets" containing crucial information on VAT rates and treatment. "It requires a lot of time and effort to keep that information current," Colbert notes. "But it is often difficult for AP staff to invest enough time to consider VAT issues when they have two to three minutes to post an invoice and complete the corresponding accounting and data entry. Even when AP teams are given adequate VAT training and supporting materials, tax professionals questioned whether AP has the bandwidth to pay adequate attention to ensuring that the tax outcome is recorded properly." Plus, tax processing rarely figures as a key performance indicator within AP groups.



VAT changes accelerate

While global indirect tax policies and rules continually change, the past dozen years or so have ushered in the modern, and increasingly digital, era of VAT compliance requirements. Brazil was the first country to implement real-time electronic invoicing (e-invoicing) and reporting (e-reporting) requirements for tax submission in 2008. Mexico followed suit a few years later with real-time VAT-reporting rules. Spain and Italy more recently became the first European countries to introduce real-time reporting and e-invoicing requirements. The UK's Making Tax Digital (MTD) effort and, more specifically, its MTD for VAT initiative were also influential in driving the shift to digital VAT return filings.

Although procurement teams do not need to possess comprehensive knowledge of all indirect tax policy and compliance requirement changes, the following milestones are useful for them to keep in mind:

E-invoicing: In 2013, Europe began liberalizing its electronic invoice regimen. “That initiated a major shift from postal invoice transmission to digital transmission that continues today,” Colbert notes. “Rather than waiting a week to get an invoice by mail, organizations could be confident that a customer instantly received its invoice.”

Self-billing: During the past 15 years or so, VAT rules have enabled more self-billing leeway, through which customers can create the invoice and send it along with payment to a supplier. This process helps improve cash flow management.

Real-time reporting: Tax authorities throughout the world appear intent on adopting real-time reporting requirements in an effort to reduce fraud, increase revenue collection, and ease their administrative burdens. “The entire indirect tax compliance process will increase in velocity towards the ultimate eventuality of everything happening in real time,” note the co-authors of the Bulletin for International Taxation article.² The implications of this shift on procurement groups and their tax colleagues are significant, notes Vertex VAT Director Peter Boerhof. “It makes getting tax right on the first instance increasingly crucial throughout Europe as well as in Latin America and the Asia-Pacific region. This movement is making manual tax coding a real headache for VAT managers.”

Procurement's rapid evolution

VAT rules are far from the only change affecting global indirect tax compliance. Procurement teams are also undergoing major transformation efforts, more recently driven by the introduction of cutting-edge technology tools. These procurement applications, whether stand-alone or part of larger ERP systems, are designed to help procurement teams make purchasing a seamless experience for colleagues, or “customers,” throughout the organization.

2. Ibid.



Procurement leaders “are working with their organizations to understand and implement digital procurement transformation using various strategies,” according to a Deloitte survey of global procurement officers. This work involves improving and automating procurement processes with modern IT applications, extending new innovative digital procurement tools/services to internal stakeholders and suppliers, and supporting enterprise digital transformation efforts.³ Current forms of procurement automation integrates supplier management, strategic sourcing, purchasing, and financial supply chain management processes so that procurement can ensure negotiated savings reach the bottom line, guide employees to buy from the right suppliers at the right prices, and effectively and efficiently manage cost accounting and payments.

Leading procurement teams also strive to automate the invoice-to-pay cycle via procurement automation and additional technologies to help generate substantial invoice-processing volume increases and higher accuracy rates while reducing processing times.

There’s an impediment to procurement’s transformation, however, and it relates to indirect tax.

Procurement systems can automate most parts of the procurement process, including data entry, data accuracy validations, and confirmations that purchases are valid business expenses transacted at agreed-upon prices. Current procurement tools can essentially automate three-way matching – a confirmation that the invoice, purchase order, and receiving report contain the same details. The matching reduces fraud risks and financial losses associated with unapproved or counterfeit purchases. As powerful as that functionality is, it only validates the taxable base (net amount) of the transaction for VAT – and cannot take into account the VAT-accuracy of purchasing transactions. This means that several common VAT-determination errors often go undetected until tax – or tax auditors – intervene. The sources of these errors include:

Improper configurations: Incorrect vendor VAT treatments can be recorded in the procurement system and then used to incorrectly deduct VAT on all similar purchases moving forward.

Self-tax requirements: When a seller charges zero percent VAT, purchasers still have an obligation to determine if self-tax (reverse charge) requirements apply.

Partially exempt businesses: In some cases, the recipient business will be partially exempt from VAT. In those cases, recovery rates can come into play. Few, if any, procurement applications contain the often complex logic needed to make these determinations.

3. Complexity: Overcoming obstacles and seizing opportunities/The Deloitte Global Chief Procurement Officer Survey 2019, 2019: <https://www2.deloitte.com/be/en/pages/strategy-operations/articles/global-cpo-survey.html>.



“The three-way match focuses on the cost and accounting elements of the transaction,” Colbert continues. “It does not validate whether or not VAT was charged and whether that rate of VAT was accurate ... If VAT cannot be validated by procurement systems in an automated manner, the VAT basically needs to be reviewed by users.” That requires more manual interventions, which add more touches to the P2P cycle. Fortunately, there is a way to reduce VAT-related challenges.

Tax technology: A valuable touch point

Even the most highly automated AP capability requires a hands-on integration between the procurement functionality within ERP systems and indirect tax automation.

“To achieve touchless AP with the proper VAT-compliance controls, you simply have to have proper tax determination functionality within your ERP and procurement platform,” Colbert asserts. “There are no two ways around it.”

Most ERP systems and stand-alone procurement platforms can be integrated with powerful tax technology that automates the VAT determination process within the P2P cycle. The benefits of limiting the need for manual VAT determination in the procurement process include:

Accuracy: Tax-procurement technology integration delivers accurate VAT calculation during the requisition and invoice reconciliation processes. During the requisition process, the tax automation lets purchasing professionals see the VAT implications, in terms of total cost, when approving or rejecting a request for purchase. During invoice reconciliation, integrated tax automation ensures that the vendor has charged the appropriate amount of VAT on the invoice, or that the customer undertakes the correct self-assessment of VAT, such as for VAT reverse charge. “With proper tax determination system in a procurement platform, every AP invoice receives an automated VAT-validation check,” Colbert reports.

Assurance: Automated VAT validation makes indirect tax teams feel much more confident about compliance throughout the procurement process. Tax authorities will also take note. “Putting in place the proper structures for VAT validation within a procurement platform demonstrates to a tax inspector that a business has a serious commitment to tax-compliant, high-quality processes and adequate audit risk controls,” Colbert points out.

About Vertex

Vertex Inc., is a leading global provider of indirect tax software and solutions. The company's mission is to deliver the most trusted tax technology enabling global businesses to transact, comply and grow with confidence. Vertex provides cloud-based and on-premise solutions that can be tailored to specific industries for every major line of indirect tax, including sales and consumer use, value added and payroll. Headquartered in North America, and with offices in South America and Europe, Vertex employs over 1,100 professionals and serves companies across the globe.

Speed and process efficiency: When indirect taxes are automatically determined (according to current rules and rates) and calculated during the invoicing process, organizations are better equipped to comply with the growing number of real-time reporting rules. From an efficiency standpoint, the automated VAT determination, calculation, and validation of most invoices greatly reduces the need for manual tax-compliance interventions. "If a business receives 25,000 invoices a month, roughly 24,000 of those invoices might automatically receive a VAT validation," Colbert explains. "The technology confirms that the applied rates, tax codes, and deducted amounts are all accurate. That leaves 1,000 invoices to be reviewed by an AP 'Super User' with advanced VAT training. That's a massive efficiency improvement compared to having AP staff manually review the VAT treatment of each of 25,000 invoices."

Conclusion: Getting on the same page

That flexibility will become more important as ongoing global indirect tax policy changes force companies to reevaluate where they operate as well as where and how they source goods and services. Successfully adapting to those changes requires procurement and tax team to get, and remain, on the same page.

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