VAT Compliance

Leveraging technology to overcome tax reporting challenges

FinancialDirector

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Foreword

Across Europe, national administrations are plugging the holes in their VAT ledgers by moving towards real-time collection of tax transactional data on digital platforms. For companies of all sizes, this is posing unprecedented challenges and leaving far less margin for error.

In this special report, Financial Director in partnership with Vertex, looks at how businesses in the UK, Ireland, and the Nordics are responding to this challenge by leveraging new digital technologies to automate processes, boost efficiency and lighten the burden of compliance.

VAT in the digital age

In the UK, the so-called 'VAT' gap reached £12.3bn in fiscal year 2019-2020, with tax authorities throughout Europe seeing similarly high tax gaps. In response, many countries have created a national requirement to file VAT returns to the national agency via a digital platform. To support this core directive, some countries are also considering mandatory use of electronic invoices (e-invoicing).

The UK is very much at the forefront of this trend. HRMC has been using online VAT reporting since 2010 and has now gone a step further with its Making Tax Digital (MTD) for VAT initiative. Phase 1 of MTD for VAT required businesses to submit their VAT returns digitally via a new API interface with HMRC, however, Phase 2 of the initiative –introduced 'digital links' to give a seamless digital journey from the records of a business through to the calculation and submission of their VAT return.

Other countries are following suit. In Norway, for example, the Ministry of Finance has introduced the Standard Audit File for Tax (SAF-T), an electronic XML-based reporting standard which is designed to make financial returns quick, accessible and universal. Finland's Financial Supervisory Authority has pushed a new ISO 20022 standard, which facilitates real-time VAT reports.

In parallel, all northern European countries are making progress towards e-invoicing, particularly for business-to-government (B2G) transactions. In compliance with EU law, all B2G transactions in Ireland, Finland, Denmark and Sweden must now be processed with e-invoices. In Norway, although not a member of the EU, has required all its public bodies to use e-invoices since 2015. There is no such requirement in the UK, but many businesses have nonetheless chosen to go down this route for both B2G and B2C invoices, working to standards which mirror EU VAT invoicing rules.

As a result of these changes, for many companies, almost the entire VAT and invoicing process is moving to digital. Although some companies still rely on non-digital techniques only, they are very much in the minority.

Compliance and reporting challenges

Requiring companies to transfer their data directly into a government platform and send digital invoices minimises the risk of errors (at least in theory) and eliminates leaky paper trails, while electronic invoices are faster, simpler, cheaper to process, and more easily stored than their paper-based predecessors.

However, these changes create a considerable burden for the companies themselves, placing a greater premium on digital expertise, effective data management and accuracy of inputs.

To begin with, there is the technological aspect to consider. Companies working towards real-time VAT reporting regulations must now produce their VAT relevant data using a digital interface that plugs straight into the digital portal used by their national tax authority. In many cases, this involves a complete departure from the processes they used previously.

This adoption carries an immediate and often large financial cost. In the UK, the requirement for digital links between software programs has become a major challenge, particularly for larger businesses. The challenge is felt across northern Europe too. In Finland, for example, tax consultant Kari Alhola notes that "the smallest companies, and entrepreneurs, may feel that digitalisation is too expensive".

But it's not just about installing complex new software. There is also an array of specifications to take on board. To produce digital invoices, for example, global companies must comply with both international frameworks (such as PEPPOL, a set of standards for business documents established by the European Commission in 2008) and local standards (such as EHF, a regime which is mandatory for the submission of invoices between Norwegian companies).

"The main challenges for companies today regarding both e-invoicing and electronic VAT reporting, I would say, are related to the format(s) used, the availability of the format specifications, the content required for reporting/invoicing and the time to prepare before implementation," says Eric Magnusson, global indirect tax solution manager at Volvo Group.

Then, there are the requirements around data management. In countries such as the UK, companies are now formally required to keep key transaction data such as accounts payable, accounts receivable and transactional listings in a digital format. All the data must not only be rendered in real-time but be stored in a way that is instantly retrievable – something that is particularly challenging for SMEs.

To achieve this, companies must rethink their entire approach to data management, according to Adam Lloyd, VAT senior manager at MHA Monahans. ▸

Compliance and reporting challenges

"Businesses have had to look at their overall VAT compliance process, the audit trail from VAT return to invoice, as well as how the information is adjusted and consolidated." Lloyd's comments are supported by Ole Basthof, head of tax at Nilfisk, who believes "we should now be looking at the full VAT compliance process - in particular where the data for this comes from, which systems are used, and how this information is adjusted and consolidated".

The picture is further complicated by the General Data Protection Regulation (GDPR), which places strict controls on the use and storage of financial information, and the ever-present threat of cyber-crime.

Conor Dillon, director at Xeinadin Group, advises a raft of Irish businesses and admits that while his clients want to ensure their data is secure and always protected, "constantly evolving technology and the sophistication of hackers and other criminal actors make this extremely challenging". The recent hack of the Irish Health Services, he says, only served to highlight the exposures that exist for all data processors.

But perhaps the biggest challenge posed by the new regulations is the need for right-first-time accuracy. Currently still much of the correction and checking of VAT returns is carried out in the reporting process itself. With real-time reporting and e-invoicing, the information entered into the system must be accurate, with the new digital gateways leaving no margin for re-keying.

"[In the past] when drafting your VAT return, you would run quality checks," says Peter Boerhof, VAT director and CTO at tax technology provider Vertex. "You may discover some errors and you'd have enough time to make corrections, make another version of your tax return and file it to the authorities.

"With real-time reporting and invoice clearance, you don't have that time anymore. So it's more important to ensure your VAT processing is right first time and that you embed your controls in your core processes, because all corrections that you make in these models are also immediately transmitted to the tax administration."

Harmonisation of rules required

It is fair to say that some countries are handling the move to real-time, digital-first VAT reporting better than others. In Ireland, Dillon says the steps being taken to respond to the changing regulations "vary widely from one organisation to another". Many businesses have adopted modern systems, with fully automated processes for both sales and purchase invoices that integrate seamlessly with the Irish tax authority's Revenue Online Service (ROS), while others are still running on paper-based systems (although it is important to note that Ireland has yet to mandate real-time VAT reporting and paper-based responses are still fully compliant).

Dillon's observations are reflected by the individual companies that spoke to Financial Director. Some say they have had no problem adapting to the new tax reporting standards. "I don't have concerns, to be quite honest with you," says Sarah Winter, financial director at a 5 Star Hotel and members' club in the City of London. "It's not an issue. There's some very good systems around and we've never encountered much difficulty in getting them to work, whether it's VAT or PAYE."

Others, however, say they have faced greater issues. The challenge appears to be particularly great for those companies that operate across several jurisdictions or rely on external service providers. As Tamara Habberley, senior VAT consultant at The VAT People, explains, such companies may find it difficult "to ensure that there is no break in the digital journey of the data, from the various back-office packages to the VAT return."

As director of finance at Hines, a property firm with offices across Europe (including Ireland and Scandinavia), Marie Christine Andela has faced major hurdles in preparing for the UK's MTD initiatives. Getting the various entities compliance ready, she says, was the biggest headache.

"We use different administrators to do our VAT filing [...] the challenge was identifying our chain and getting everybody on board to ensure that each level of the chain remains compliant," she says. "Internally, our focus was ensuring everyone understood the requirements of MTD, including limited manual input, and deciphering where manual inputs had to be made digital. Training wasn't necessarily a challenge for our employees, but we had to make sure that the service providers we use were ready.

"Our accounting package needed to be compliant with the UK Government API. Externally, our service providers tend to use different accounting software. Again, the challenge was ensuring that if those providers are using different packages, they are also ready for the changes." ▸

Harmonisation of rules required

Companies across Europe are experiencing similar challenges, with the sheer variety of platforms and procedures from one country to the next a common point of contention for many corporates.

Anna Sandberg Nilsson, an advisor on VAT policy for the Confederation of Swedish Enterprise admits that in addition to the complexity of Sweden's VAT rules, companies are frustrated by the fact "that different countries are using different solutions [which] creates problems, high investment in IT and very high compliance costs – a harmonisation is needed."

Such sentiments are reflected by Volvo's Magnusson: "We have seen cases where a country might make changes to a format specification closely before the implementation date or the specification is only available in the local language. This [is] in addition to the fact that there are different formats used in different countries or there might be different content required in the reporting."

Leveraging technology

Happily, a raft of software providers has emerged on the scene in recent years, specifically designed to facilitate digital-first reporting. These solutions simplify the process of interacting with tax authorities' gateways and provide cross-border solutions tailored to different tax systems. Crucially, they are also designed for simplicity, so companies of all sizes and technical proficiencies can utilise them.

For companies which are still migrating from old pen-and-paper reporting, this kind of technology can be particularly useful. Clair Sandell, chief accountant at Mercedes-Benz Retail Group, says that her company's invoice-processing system has been significantly streamlined by invoice technology providers. "The software reads details like vendor name and purchase order numbers using machine learning and directs the invoice to a workflow, where an invoice needs to be approved," says Sandell. "On occasion, if the software can't read anything, it goes into a rejection process. It's all fully automated."

With all these technology developments still the bedrock of the VAT reporting function remains the Enterprise Resource Planning (ERP) system. "ERP is the backbone of a financial system of a company, and it's used as the root system for processing invoices," says Vertex's Boerhof. "So it's then also logical that, in order to avoid any manual changes, that the information comes from your ERP rather than any other system.

"If you are engaged in tax audits from administrations, they consider your ERP to be your source of truth. That's what they're going to assess you on."

Little wonder then, that the global ERP market is expected to grow by $46.96bn by 2027, according to Allied Market Research, with much of the demand coming from the accounting and finance industry. And the potential is only increasing due to the use of cloud technology, which minimises the cost of installing updates in response to new legislation and provides enhanced data security, minimising the chance of information becoming corrupted or damaged.

Accuracy is everything

But despite all these impressive digital advances, the entire system will fall if the basic information is not correct. So, how confident are today's companies that their tax data is accurate?

Opinions differed among the companies Financial Director spoke with. For Winter's, the accuracy of her tax data is paramount.

"In hospitality we have to be on the money," she says. "The system has to tell me what's going on at any point in time, so sales are never an issue. Yes, a purchase invoice can be missed but you know with purchase order software which ones are meant to be in."

Others at larger organisations are more cautious, however. "I don't think you can ever be 100 percent," says Mercedes-Benz's Sandell. However, she admits that despite the end-to-end VAT process being scattered across various departments investments in technology ensure that tax data is as accurate as possible.

Maintaining 100 percent accuracy is "important, yet challenging," says Hine's Andela. "It is easy to miss something when you are exporting data as you are working across different variables. If you miss out a couple, the tax data ends up being inaccurate." Thankfully, advances in tax automation are helping businesses catch errors in the data and helping companies improve the end-to-end VAT process to improve compliance while also reducing costs.