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Global digital services: a tax compliance guide

Practical considerations of implementing a global tax compliance strategy

If you are a digital business, it is essential to understand that many tax authorities worldwide apply tax at destination. Legislative changes in the United States first introduced in 2018 allow individual States to levy sales tax on out-of-state vendors (including non-US vendors). This means that businesses will be paying more taxes to a growing number of tax authorities, year on year. Likewise in European countries, where the place of supply for B2C is allocated to the country of residence of the customer.

The changes are due to the rise of internet retail and digital services, that can easily be provided to customers globally from a single location. To ensure consumption is properly taxed. Tax authorities are increasingly moving to tax models based on the location of the customer rather than the physical location of the business selling.

This guide helps you understand the practical issues involved in incorporating destination based taxation rules into your business operations.

What you need to know

1 – Determining customer location, and tax calculation

The starting point when calculating VAT/GST/sales tax is to determine the customer's location so you know which rules and rates apply.

Data required for this includes:

- **Customer billing address**
- **Device IP address**
- **Bank details, such as the location of the bank account used for payment or the address of the customer held by the bank**
- **Mobile Country Code (MCC) of the International Mobile Subscriber Identity (IMSI) stored on the SIM card used where a customer orders using a mobile phone**
- **Location of the customer landline through which the service is purchased**
- **Credit card Bank Identification Number (BIN)**
- **Other commercially relevant information, such as a loyalty card or subscription numbers**
- **ZIP code + 4**

But determining location can be less than straightforward. Some countries need only one piece of location evidence, others need two pieces of non conflicting evidence. In the latter scenario if the evidence conflicts, then in theory the customer location can't be determined.

An example would be where the customer billing address does not match the country of the device IP address, which in turn does not match the issuing country number of the BIN on the credit card. In these cases, self-declaration - when not determined by legislation - i.e. allowing the customer to confirm their location - may be required. It is also key that you define a logic hierarchy for evidence collected, this hierarchy is extremely important where pieces of evidence are conflicting, e.g. always prioritise payment information where conflicting evidence arises. Whatever method you choose, it's important to avoid any disruption to the customer journey. Everything must happen quickly and seamlessly, so the customer isn't kept waiting during checkout.

Key considerations

1. Customer location determination is integral to digital service VAT/GST calculation, but evidence collection can conflict and in turn disrupt the customer's purchasing journey.
2. A consistent approach to determining customer location will provide peace of mind that you are always applying the correct tax rule.
3. Friction-free tax calculations must be made in milliseconds to give a smooth customer experience with no delays during the checkout process.

2 – Understanding tax thresholds

Your liability for paying consumption tax on digital services in each country will depend on the threshold set by the taxing country.

Examples of the varying thresholds currently in operation around the world include:

- **No threshold for any supplier** - Chile and Colombia currently have no threshold. This means in general that you must register and file from the first sale you make in these regions.
- **Threshold only for micro-businesses** - the EU introduced a €10,000 (approx. USD$10,816*) threshold for micro-businesses established in the EU for cross-border sales.
- **No threshold for a foreign supplier** - sometimes there is only a threshold for domestic businesses, with no threshold for foreign suppliers, e.g. Bahrain, Saudi Arabia, UAE, India.
- **Threshold issued on global sales** – e.g. Switzerland, which uses a global sales figure of CHF 100,000 (approx. $115.976*), i.e. if you have global sales over this figure you are liable for tax in Switzerland from your very first sale.
- **Thresholds that depend on both the value of sales and the number of transactions** – e.g. in the United States, a trend of a threshold of $100,000 in sales and/or 200 transactions at state level is emerging but is not consistent across every state.

*Note: Foreign exchange calculations from 15:00pm on Thursday, February 1, 2024, using xe.com

Key considerations

1. The rules are constantly evolving, this requires resources to monitor.
2. Sales analysis must happen per region on an ongoing basis, as tax thresholds may be breached with growing sales.
3. Just one sale could be enough to make you VAT/GST liable.

3 – Applying foreign exchange (FX) rates

When you invoice in a foreign currency, the relevant VAT jurisdiction usually requires that some of the amounts included in the invoice (e.g. the calculated VAT), to be expressed in the local currency.

It can also occur that you need to convert a foreign currency to euros for VAT reporting purposes.

In both cases, it's vital that you apply the correct foreign exchange rate for both invoicing and filing. As you might suspect, this is less than straightforward. It's not possible to apply a single exchange rate source across all countries; instead each tax jurisdiction dictates which exchange rate source must be applied. This in turn means you need a robust system capable of ensuring the correct source is selected for each jurisdiction. Furthermore, you need to define at what time the FX rate should be applied, at the time of the transaction, the time of the invoice or the end of the reporting period.

Here are some examples of FX rate sources that must be used in these specific jurisdictions:

- **Bahrain:** The rate changes are notified by the publication of laws in the official gazette, the source is the website of the Bahrain Tax Authority.
- **European Union (E.U.):** The FX rate source is provided by the European Central Bank (ECB).
- **Norway:** a weekly FX rate is set by the Norwegian Customs Authority.

Key considerations

1. There are multiple possible sources of FX rates.
2. You must apply the FX rate from the source dictated by each taxing jurisdiction.
3. Your systems must be capable of sourcing the correct rate for each jurisdiction.

4 – Compliant invoicing

Each country's tax regulations include invoicing rules. In some countries these rules are simple - in Australia, for example, no set invoicing requirements are imposed, you may follow the invoicing rules of the country where your business is located. However, other countries insist on more complex invoicing rules, and any rule that applies to an invoice also applies to a credit note.

The most common and basic invoicing rules include:

- **Specific date formats**
- **Sequential invoice numbering per country**
- **Display of tax amount**
- **Indicative foreign exchange rate on tax amount**
- **VAT/GST registration number**

Invoicing requirements include:

- **Country specific invoicing** e.g. Saudi Arabia requires both Arabic and English, Serbia requires Serbian and English.
- **Uniform Invoice lottery** e.g. Taiwan implemented the 'Uniform Invoice lottery' for digital sales from foreign companies. All online sales made within the country must contain a 'legally generated lottery number' which each customer can use to enter the state lottery. The aim of the initiative is to encourage people to request an invoice, in turn leading to higher tax collections.
- **Signature of the authorised representative** e.g. India and Belarus require a company to issue an invoice containing the signature of a senior authorised representative of the company.
- **Identifying the tax agent on the invoice** - in countries where a tax agent is required, the invoice may require the details of the agent showing them as liable for the tax relating to that sale.
- **Service Accounting Code** - India assigns a unique 'service accounting code' to each OIDAR (Online Information and Database Access Retrieval) service category, which must be shown on the invoice.

Key considerations

1. The lack of standardisation and harmonisation in invoicing rules makes compliance complex.
2. The rules applicable for invoices in general apply to credit notes.
3. In B2B transactions, a legally compliant invoice is required for customer's input tax deduction.

5 – VAT/GST number validation / United States tax exemption certificates

There are many tax jurisdictions that apply a reverse charge rule to business-to-business (B2B) sales transactions. Essentially this means the seller will not charge VAT/GST on the invoice as the recipient will self account for this tax. There are also markets that apply an exemption certificate e.g. the United States. These exemption certificates apply depending on the status of your business or the reason for the purchase.

You may think a reverse charge system simplifies your tax obligations as there's no need to charge and collect VAT/GST on sales to business customers. In practice, this isn't the case, because it's down to you to ensure the customer is a valid business when invoicing.

Instead of charging VAT, an extra step is needed in which you validate if the customer makes the purchase as a business customer or a private individual.

As businesses typically are registered for VAT/GST purposes, collecting this number is crucial. As an additional step, jurisdiction (like the EU) may require you to validate the VAT/GST number against a tax authority database.

On the other hand in the United States, you need to collect tax exemption certificates from tax-exempt customers. There is no uniform system for these tax exemption certificates and managing them effectively can be challenging.

Key considerations

1. Automated VAT/GST number validation processes vary in different countries.
2. When applying a reverse charge, the onus is on you to prove that your customer is a valid business for VAT/GST purposes.
3. When not charging tax in the United States, you need to collect tax exemption certificates from customers.

6 – Data storage

Transaction data must be kept securely, and you must be able to access this storage if required during an audit.

Requirements vary across jurisdictions as to exactly what data must be kept and how long it must be retained.

For sales to EU customers, without being exhaustive or complete, the information that must be archived for a period of 10 years includes:

- Country to which the service is supplied
- Type of service
- Date of sale
- VAT rate applied
- Amount to be paid in local currency
- Date and method of receipt of payment
- Invoice

Other archiving periods:

- Bahrain: 5 years
- New Zealand: 7 years
- United States: data storage rules vary from state-to-state but there is a trend emerging of an average storage period of 7 years.

Key considerations

1. You must keep transaction data for potential audit purposes securely.
2. You must ensure you retain the transaction data as specified per each taxing jurisdiction.
3. Time limits for data storage vary on a country-by-country basis and in the United States on a state-by-state basis.

Where do you go from here?

As your business grows and develops, you don't want to be restricted by tax compliance requirements. To make the most of global opportunities, you want to be able to sell to anyone, anywhere, anytime – and to do so in a way that is compliant and hassle-free. It is important to understand your business needs and consider how you can handle some of the following areas.

Keeping business friction-free

You want the solutions you choose to support tax challenges allowing you to deliver both friction-free customer experiences and friction-free internal processes. This means that in addition to covering the day-to-day transactional issues, you must also be prepared for changes at short notice – which happen frequently. When you incorporate tax compliance into the digital sales process, the customer journey must stay as fluid as possible, yet still allow you to collect all the information required by tax authorities. Whatever technology you use, it must be capable of handling validation checks and foreign exchange calculations without adding any delays or barriers that might put the sale at risk.

Compliance resourcing

Because of the enormous variety of requirements across the various tax jurisdictions, compliance management can be a substantial drain on resources. It's no surprise that many businesses resort to tax advisors, despite the substantial costs involved. It is important to evaluate not only your current business position and sales regions but also how quickly your sales are growing. Rapid global expansion may affect your compliance requirements sooner than you think.

Keeping systems up to date with tax rates and rules changes

Though rules and rates are changing, tax authorities don't always consider the need to give businesses adequate time to update systems, processes or resourcing to manage these changes effectively. For example, India introduced its digital tax legislation on 10 November 2016 to go live by 1 December 2016. Tax rates can be changed quickly too, e.g. Greece raised its VAT rate from 23% to 24% in June 2016, with one week's notice. Where a rate increase occurs and systems can't be updated in time, businesses must pay the extra tax amount due without being able to collect it from customers. Having an agile process to allow your business to adjust quickly and easily to these changes is essential.

Proactive Global Sales Reporting

Proactively monitoring global sales will mean that you will never be caught off-guard by surpassing tax thresholds and unknowingly exceeding the threshold where you are required to register for tax in that jurisdiction.

For more information, contact Vertex today at vertexinc.com/en-gb/contact-us

About Vertex

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