VAT and GST
Multiple burdens for multinational companies
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Introduction

The global financial crisis has put a strain on corporate profits, reducing profits tax revenues. Together with the cost of fiscal stimulus measures, the downturn has resulted in historic budget deficits in many countries.
Governments around the world now need to balance their books and they are increasingly looking to indirect taxes on consumption to make up the shortfall. Consumption taxes include value added taxes (VAT), goods and services taxes (GST) and sales taxes; but, for ease of reference, in this paper, we will refer to these taxes collectively as VAT.

What does an increased focus on VAT compliance and enforcement mean for tax administrations and taxpayers? Will it inevitably result in more administrative requirements, stiffer penalties for errors and an increase in the VAT compliance burden? If so, multinational enterprises (MNEs) will likely face increased costs and resource requirements, as they are called on to adapt their business and enterprise resource planning (ERP) systems to comply with the many and varied obligations imposed by different tax administrations around the world. But as VAT obligations multiply, full compliance becomes harder, increasing the likelihood of making errors and incurring penalties and increasing the tax risk.

Can governments and MNE taxpayers ever aim for the same VAT compliance goal? At Ernst & Young, we believe that a number of practical measures could be adopted by countries to improve VAT compliance performance by reducing the burden on MNEs. We contend that highly complex VAT rules are counterproductive, as they make it harder for honest taxpayers to meet their obligations accurately, which diverts tax administrations’ efforts towards catching formal errors and away from detecting VAT fraud. By developing an approach based on cooperation rather than confrontation, and by focusing on simplification and harmonization of key concepts, we believe that MNE taxpayers and tax administrations could meet their obligations, using their scarce resources, more effectively.

In this paper, we consider the multinational VAT compliance burden borne by MNEs and suggest ways in which the VAT compliance system could be improved for the benefit of MNE taxpayers and tax administrations. Our suggestions are based on research covering the VAT system in 90 countries,2 subjective feedback from our Ernst & Young Indirect Tax network of VAT professionals in 40 leading countries, as well as selected interviews conducted with corporate tax directors and tax administration officials.

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1Most countries worldwide levy a VAT or GST. Although the detailed VAT or GST rules vary between countries, the compliance issues are broadly similar in most VAT or GST systems. Even in countries that do not levy a VAT or GST, the compliance issues outlined in this paper may be relevant to local sales taxes or Business Services Tax.

2Algeria, Angola, Argentina, Australia, Austria, Azerbaijan, Bangladesh, Barbados, Belgium, Bolivia, Brazil, Canada, Chad, Chile, China, Colombia, Congo, Costa Rica, Croatia, Cyprus, Denmark, Dominican Republic, Ecuador, Egypt, El Salvador, Equatorial Guinea, Finland, France, French Guiana, Gabon, Germany, Ghana, Greece, Guatemala, Honduras, Hungary, India, Indonesia, Ireland, Israel, Italy, Ivory Coast, Jamaica, Japan, Jordan, Kazakhstan, Latvia, Lebanon, Luxembourg, Malaysia, Mali, Mexico, Morocco, Namibia, Nepal, The Netherlands, New Zealand, Nicaragua, Nigeria, Norway, Pakistan, Panama, Peru, Philippines, Poland, Portugal, Puerto Rico, Romania, Russia, Senegal, Singapore, South Africa, South Korea, Spain, Sri Lanka, Surinam, Sweden, Switzerland, Taiwan, Tanzania, Thailand, Trinidad and Tobago, Tunisia, Turkmenistan, Turkey, United Kingdom, Uruguay, Venezuela, Virgin Islands, Yemen.

3Argentina, Austria, Barbados, Belgium, Botswana, Bulgaria, Canada, Croatia, Cyprus, Czech Republic, Denmark, Estonia, France, Germany, Greece, Hungary, Indonesia, Italy, Japan, Kenya, Latvia, Lithuania, Luxembourg, Malta, Namibia, Norway, The Netherlands, New Zealand, Pakistan, Portugal, Slovakia, Slovenia, Spain, Sweden, Switzerland, Trinidad and Tobago, United Kingdom, Zambia.
The business burden of VAT

What is 100% VAT compliance?

Before we look in depth at some of the issues faced by MNEs, let us first consider what we mean by “100% VAT compliance.” At Ernst & Young, our definition of full compliance is paying the right amount of tax, at the right time, to the right tax administration.
VAT and GST: multiple burdens for multinational companies

“...the business is dynamic and moving. You have to find a balance. We aim for 100% VAT compliance but, in reality, 100% compliance is impossible.”

The Head of Indirect Tax of a European automotive company

Full VAT compliance may seem a simple goal; but, in practice, it can be hard to achieve. Complications arise from a number of sources, including the demands of real-time VAT reporting, the large numbers of transactions undertaken by MNEs, the complexity of VAT, the new ways that global companies are conducting business, the detailed formal obligations imposed by individual tax administrations, the pace of legislative change and the differences in VAT laws and obligations imposed by different countries.

Unpaid tax collectors

Indirect taxes on spending (or “consumption”) are generally borne by final consumers, but they are collected and remitted by business entities that supply taxable goods and services. VAT is charged at each stage of the supply chain, with taxable businesses allowed to recover or offset VAT paid by them on their business costs and expenses. This method of charging and collecting tax from non-taxable persons using VAT-registered businesses makes VAT a highly cost-effective form of taxation, from a government perspective.

Indeed, many businesses complain of their role as the “unpaid tax collectors” of the VAT system. They are highly responsible for accurately administering a tax that, in theory, they do not actually pay. The tax burden of multinational VAT compliance is the additional cost to MNEs of adopting, operating and adapting their accounting processes and reporting systems to account accurately, over and above what they would spend for their own commercial purposes.

The burden includes the cost of obtaining information, training staff, dealing with VAT audits, enquiries and disputes, the cost of financial penalties (which are not generally deductible against profits for direct taxation) and the cost of VAT related to legitimate business expenditure that is not recovered (e.g., in foreign jurisdictions).

Many companies also have to factor in the impact of negative VAT cash flow, which may arise from the sales or purchase functions. On the sales side, the supplier typically has to fund VAT charged to customers that has not been paid by the time the return is due or which is never paid, especially in countries where no relief is given for bad debts.

On the purchase side, waiting for VAT refunds can greatly add to the effective VAT burden for businesses that have large VAT credits, accruing, for example, from start-up or merger costs or as a result of capital investments, or persistent VAT credits resulting from business activities that are not subject to VAT or to the full rate of VAT. Of the 90 countries we surveyed for VAT obligations, only 21 countries refund VAT credit balances automatically on receipt of a VAT return, while 69 countries require the taxpayer to either request the refund or carry the VAT credit forward to offset future VAT liabilities. One country makes no refunds at all. Refunds may also be delayed if an audit must be carried out before the credit is repaid.
Obtaining VAT refunds in the EU

The Global VAT Director of a multinational based in Switzerland, which manufactures and distributes agro-chemical products, talks about the company’s experience of obtaining refunds in the EU as a non-EU company:

“Our supply chain activity, which is managed and performed out of Switzerland, sources the raw materials required for manufacture and owns all the products up to final distribution. The Swiss company is registered for VAT in a number of EU countries. In the majority, it is in a VAT refund position.”

“Of course the process for refund differs between countries. In some, refunds are automatic, in others; such as Austria, VAT credits tend to be only refundable following an audit. We have an ongoing Austrian audit and we seem to have an audit for every claim. That may be partly due to the fact that we've not consistently asked for refunds in Austria previously, because it triggers an audit, which stops everything until it's resolved. Of course, we need to plan for the documentation and information we need to provide, as it takes quite a bit of resource to get everything together to deliver to the auditor. But because the previous audit revealed no issues and we're expecting the same for this one, we will be changing our approach. We're going to ask for refunds promptly every quarter. It remains to be seen what the Austrian administration’s reaction to that is, because I can't imagine that they'll want to audit us every time.”

VAT “throughput” increases tax risk

The Head of Indirect Tax Director of a European automotive company comments on the level of indirect tax risk faced by multinational companies:

“The management of many blue-chip companies don’t realize how much is at stake with indirect taxes. But the amount of VAT handled by a large organization makes it a priority. You have to think of the “throughput” – that is, all the VAT you handle or could be responsible for. It's not just VAT on in-country sales – you also have to look at purchases. And you have to remember that exports and other zero-rated and exempt activities are all liable to VAT unless you can prove otherwise.”

“...The level of error in a VAT compliance system – even a well-controlled one – may easily be 5% or higher. With a global VAT throughput of €7 billion, say, if 5% is wrong, you are looking at a VAT error rate of €350 million annually. If you consider that any assessment is going to go back maybe up to five years, and you have penalties and interest, you may easily be looking at €1 billion to €2 billion of risk...”
“In this difficult time, the protection of our tax base and the efforts to combat tax fraud and tax evasion are all the more important, especially given the extraordinary fiscal measures adopted to stabilize the world economy and the need to ensure that economic activity is conducted in a fair and transparent manner.”

The Leaders of the G-8 July 2009

Protecting the revenue

On the other hand, allowing businesses the opportunity to collect and retain large amounts of tax can leave the system open to fraud and manipulation by dishonest traders. To protect their tax bases, tax administrations need to protect their consumption tax receipts, especially against systematic VAT fraud. This imperative is stronger than ever as the revenue focus is shifting in many countries from taxes on income to taxes on consumption. As VAT is collected throughout the calendar year, not just at year-end, maintaining the flow of VAT receipts is also crucial to helping governments manage their cash flows effectively.

Tax administration viewpoint

Shane Reardon, Deputy Commissioner, Goods and Services Tax (GST) of the Australian Tax Office (ATO) outlines his department’s main compliance objectives for GST:

“Our main objective is to create an environment where corporates can comply with their GST obligations and all our efforts are really focused on that. We’ve put a range of strategies in place ranging from education to opportunities to work with us on a one-on-one basis at a relationship level, through to our audit programs. But our priority is to create an environment that makes it as easy as possible for corporates to comply with their GST obligations.”

“The second thing for us — and I’m sure elsewhere too — is that as we come out of the global financial crisis, as we recover, we must make sure that GST compliance is still strong.”

“What do I think that corporate taxpayers can do to improve their GST compliance? Regularly review their procedures and processes, staff and IT systems as a matter of course, because that’s where we find most mistakes. The business areas of large corporates aren’t always aware of the potential GST consequences of transactions. Consultation between business units and the tax function for major transactions in particular would be helpful to make sure that the GST implications are considered for transactions.”

“They can also adopt a professional and open relationship with the tax authority where there is open disclosure, as well as early disclosure. To create an environment that provides certainly to large corporates — and we do understand that they need that -- corporates are going to have to trust us by engaging with us early in order to provide that certainty.”

4 Ernst & Young Tax Policy and Controversy Briefing Issue 3, February 2010. See www.ey.com/tpc

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It is understandable that tax administrations take VAT compliance very seriously and that they seek to impose stringent tax accounting rules and penalties related to VAT collection. But, in their efforts to ensure that all the VAT due to them is paid at the right time, are they actually making full compliance less likely? In this paper, we consider some possible reforms that MNEs consider would support the improvement of their VAT compliance performance, while reducing their VAT compliance burden.

Real-time reporting

One of the biggest compliance challenges for MNEs is capturing the information they need to complete their VAT returns accurately within tight deadlines. The nature of VAT effectively requires taxpayers to account for every business transaction accurately in “real-time” – as the tax treatment of each supply of goods or services is decided when it takes place and must be reported and accounted for in the VAT return shortly after the transaction, generally in a monthly VAT return.

We studied the detailed VAT reporting obligations in 90 countries with a VAT system, across more than 100 individual requirements. One of the criteria we examined was the time limit for issuing a tax invoice. For MNE taxpayers, this is a day-to-day task that applies to large numbers of transactions, and many jurisdictions impose penalties for individual invoices that are not issued on time or that contain errors.

!”We encourage all countries to ensure that simplification of VAT without putting the fight against VAT fraud at risk is carried through in the years ahead. In particular, we encourage tax administrations to ensure that they provide business with certainty and clarity in the way that the tax is applied and that the compliance costs can be minimized.”

Organisation for Economic Cooperation and Development
Lucerne Conference September 2009

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Figure 1: Deadline (in days) for issuing a VAT invoice

Source: Ernst & Young
We found that in most cases there is little time for taxpayers to make VAT decisions related to their transactions. In just under two-thirds of countries surveyed (59), taxpayers must issue a VAT invoice on the same day that the transaction takes place. Even where taxpayers have some time after the transaction to issue their invoices, in all but three countries we examined (Austria, Germany and Ivory Coast), the invoice is required within one calendar month.

Stephen Bill, Advisor to the Director General for Taxation in the European Commission talking at the Ernst & Young 2010 Indirect Tax Symposium in Budapest, discussed the importance of VAT as a source of revenue as countries recover from the economic downturn:

“VAT is likely to play a key role in the fiscal ‘exit’ strategies which many countries have been forced to adopt in the wake of the recent financial crisis. Many economists agree that a shift from personal and corporate income tax to consumption, property and environment taxes will help stimulate growth. In other words, greater reliance on VAT will contribute towards a better quality of revenue-raising by making tax systems more ‘growth friendly.’ I think economists have got it right on this, particularly if one takes into account that one of the deepest and most long-lasting socio-economic problems arising out of the crisis is growing unemployment. Even if governments do not follow a policy of tax shifting, VAT will still have a role to play by helping to raise the additional revenues many countries need to correct the massive fiscal imbalances which have built up over the last few years.”

“Within the EU we have already seen several Member States raise their standard rate of VAT (the latest being Finland). Interestingly very few went down the road of cutting VAT to stimulate growth – notably the UK – but this was only a temporary measure and has now been reversed. I think we can safely conclude therefore that governments will indeed look to VAT as a source of extra revenue over the next few years. However, this does not of course have to be done by raising the standard rate. The other possibility is to curtail the scope of reduced rates and/or exemptions.”

“Whether or not governments examine their reduced rates and exemptions, we can, I think, conclude that the maintenance of a healthy revenue stream from VAT will be a central plank in most governments’ fiscal policies for years to come. But how robust is the tax and how reliable is it likely to be in delivering this much needed revenue? The threats which tax administrations perceive, and the way they react, will go a long way in the coming years towards driving tax policy as regards to the mechanics of the system. In this context, I think two areas of perceived threat have, and will continue, to drive VAT policy. The first is the tax treatment of services capable of being delivered from a remote location. The second is the need to counteract fraud and evasion.”
Filing VAT returns is another task that requires accuracy within a limited time period, which can prove challenging for large organizations with complex business activities but limited resources. In the 90 countries we examined, the large majority required taxpayers to submit completed VAT returns within one month after the VAT return period, with only eight countries allowing a longer deadline. The most common reporting deadline is between 15 and 30 days, and in four countries (El Salvador, Germany, Honduras and Mali), the deadline is 10 days.

In general, the shorter the VAT reporting period, the shorter the filing deadline; apart from five (Austria, Egypt, Finland, Japan and Portugal), all of the countries that require VAT returns to be submitted monthly have filing deadlines of 30 days or less.

“...while most GST or VAT systems have the inherent requirement of intensive record keeping. In South Africa, the requirement to maintain VAT records is more or less aligned to accounting practices and practices required by other statutory institutions. This alignment is an effort to reduce the burden associated with maintaining VAT records. Large businesses, through the stakeholder forums have not raised this issue as being overly burdensome. SARS does not view the requirement to maintain VAT records as being more stringent than the normal corporate governance rules that any company would have to abide by.”

Prenesh Ramphal, Senior Manager of VAT Research and Development, South African Revenue Service (SARS)
Paying the right amount of tax

The VAT Director of an MNE based in more than 100 countries comments on what paying “the right amount of tax” means to his organization:

“When you go into a foreign jurisdiction it’s very easy to err on the side of conservatism. We have a high degree of control over the selling side of our business and we tend to err on the side of ‘if in doubt, charge the VAT’ because it’s the low risk option.”

“On the purchase side, it seems to be true all over the world that tax administrations are very happy to collect tax, but less happy to repay it and to allow deductions. They will pay deductions when you can sustain them, but you have to jump through all the hoops.”

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“Tax administrations don’t seem to understand how long processes can take in a complex organization. Paying an invoice doesn’t happen in 10 days – typically it can take 90 days from issue for an invoice to go through the system. Capturing accounts payable invoices dated rather than paid within a specific month is particularly hard for us. But in some countries you need to do that to claim any input tax.”

The Global VAT Director of a large financial institution comments on the practical difficulties that short reporting deadlines pose for complex organizations:

“Our major VAT compliance reporting issue is capturing data in the time limits allowed. In the UK, for example, we have a complicated VAT recovery method. The data we need for the quarter is not always available within the 30-day period for doing the returns. In other countries it’s even worse, with 10-day deadlines in some cases.”

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The “right” amount of tax?

Paying the “right” amount of VAT means not paying too little VAT — or too much.

The VAT system provides that registered businesses may deduct or recover VAT paid on most legitimate business expenses. However, not all VAT is recoverable — different countries either allow or block different expenditure, especially related to travel and expense costs. For example, if an MNE hosts a conference for its sales force in country A, all the hotel and catering charges may be treated as recoverable, whereas the same costs may be blocked if the conference is held in country B.

Foreign VAT recovery

Even for accepted business expenses, recovering foreign VAT may be an issue and most MNEs incur VAT in countries where they are not established. Although there are mechanisms for mutual VAT recovery, most notably in the EU, many countries around the world do not refund VAT to non-resident businesses. Even where a refund scheme exists, it may not be open to businesses from particular countries (such as to businesses established in the non-EU countries that do not refund VAT) or it may be difficult for foreign companies to fulfill the requirements in practice.

The Organisation for Economic Cooperation and Development (OECD) recently reported on this issue. In 2006, the OECD’s Committee on Fiscal Affairs (CFA) adopted the principle that “the burden of value-added taxes themselves should not lie on taxable businesses except where explicitly provided for in legislation.” It undertook surveys of both governments and businesses to estimate the extent to which this principle was applied to VAT incurred abroad. The OECD’s report, published in February 2010, indicated that, although most OECD member countries have implemented VAT relief procedures, they are frequently complex. More than 80% of businesses surveyed by the OECD indicated that they cannot recover all their foreign VAT and more than 20% reported that they are unable to recover any foreign VAT, at all. A large number (72%) of the businesses surveyed said that they found these procedures “difficult,” and a third said that these difficulties influenced decisions on investment.

The OECD comments about the survey: “... businesses would like to see improved communication with tax administrations. Greater harmonization and standardization of the procedures would speed up and improve these repayment systems. The CFA will continue to work on these issues with a view to helping countries improve their VAT relief procedures while at the same time providing safeguards against fraud.”

Paying VAT twice

Economic double taxation is a genuine risk in some business sectors. Complex transactions may be hard to classify for VAT purposes; this increases the likelihood that countries’ VAT systems may treat the same activity in different ways or that tax administrations may arrive at different conclusions based on the same facts. For certain types of trading activity — for example, cross-border supplies of energy — different rules mean that VAT may apply in more than one territory for the same transaction. Therefore, as matters currently stand, paying the right amount of VAT in these cases means paying tax twice. There is currently no formal mechanism for individual countries to resolve these instances of double taxation, as VAT is not covered generally by international double taxation agreements.

As VATs have been spreading across the world, international trade has also been expanding rapidly. As a result, the potential for double taxation and unintentional non-taxation has increased.”

The Organisation for Economic Cooperation and Development

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5 VAT/GST relief for foreign businesses: the state of play OECD 2010
Commenting on the current position, the OECD notes that businesses may be dissuaded from making investment or trading decisions because of uncertainties about the application of VAT while tax administrations struggle with applying the tax on international transactions where there are no internationally agreed rules. However, the OECD is now developing draft international VAT guidelines\textsuperscript{6} setting out how international transactions should be taxed for VAT purposes, which it hopes will benefit taxpayers and tax administrations alike.

\textbf{The flat world effect}

Few companies do business today in the same way and in the same markets as they did 10 or even 5 years ago. Business models have evolved and are constantly evolving. VAT systems can struggle to keep pace with globalization; in most countries, the basic legislation was adopted many years ago, before, for example, the advent of e-commerce and when fewer companies engaged in cross-border trade.

Each change in how or where an MNE does business has far-reaching implications for its VAT compliance. As businesses evolve, they must constantly review their VAT reporting obligations, including the impact on their financial situation and working capital requirements.

\textsuperscript{6}OECD International VAT/GST Guidelines, OECD 2010
VAT is a moving target

VAT legislation is also a moving target, with an elevated volume of legislation in this area reflecting the fact that many governments are moving towards consumption taxes as a source of additional revenue. At the start of 2010, for example, Ernst & Young issued a report titled *Indirect Tax in 2010*,\(^7\) which detailed a large number of VAT changes expected around the world in the coming year. Changes include VAT rate increases, new VAT place of supply rules for cross-border services supplied in the EU and VAT reforms in Switzerland, Norway and Malaysia. Despite reporting actual or anticipated VAT changes in 34 jurisdictions, the list was not exhaustive, with more developments announced or likely to be announced as the year progresses. In China, for instance, large numbers of administrative and legislative changes related to business services tax (BST) are notified to taxpayers each year, and it is estimated that more than 300 state and local level BST circulars were issued in 2007 alone.

Keeping up to date with developments around the world can become a full-time task, and it poses a major challenge for all global companies in meeting their real-time VAT reporting obligations. Even if a global company is 100% compliant on 31 December, it is unlikely to be so on 1 January without undertaking a comprehensive review of all the possible legislative changes around the world that could affect its operations and adjusting its accounting processes accordingly.

Multinational company, multinational burden

MNEs face two major VAT compliance problems: not only do they need to deal with very complex VAT laws in most countries, they also have to deal with different rules in multiple jurisdictions.

Tax administrations tend to see VAT compliance in local terms. So, although simplification of individual VAT systems would help reduce the compliance burden for MNEs, it is not necessarily enough. The real issue is that individual countries’ systems are not aligned, with such lack of alignment even occurring across the 27 Member States of the EU. There are major differences around the world regarding when reports are due and what must be reported, which in turn has a significant impact on ERP systems. Each tax administration expects complete compliance with its requirements – irrespective of what any other country may require. So, even if each country’s own VAT system could be made simpler, MNEs would still experience complexity arising from dealing with multiple “simple” systems. This factor alone greatly increases tax risk and MNEs’ need for investment in compliance processes and resources.

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\(^7\) See [www.ey.com/indirecttaxin2010](http://www.ey.com/indirecttaxin2010)
The VAT Director of an MNE talks about the challenge of entering new markets:

“I believe there is a fair degree of consistency regarding what we do, so it should be possible to say ‘if we do this, then the VAT treatment is likely to be this in these countries.’ To keep it right is to recognize that it is ‘likely’ rather than ‘absolutely certain,’ and actually getting certainty about whether you are right or wrong on that is important.”

“But the other thing – and I think this is key – is what you think you’re going to do at the start isn’t necessarily what you discover you are doing halfway through. One of the most difficult factors is that business – and what you do in business – is flexible. So, you can discover that what you actually did was slightly different – and the consequences are different too.”

New markets, new challenges

The VAT Manager of a European oil company:

“Our contracts are complex and decisions are made very fast. A cargo may set out destined for sale and delivery to one buyer, but, while it’s in transit, it may be sold to a different purchaser or it may be split, so the VAT treatment changes. It’s hard to keep up from a compliance point of view and if VAT is suddenly added to the price and it can’t be passed on, there may be no profit.”

Fast-moving business
A working sales invoice

A simple and telling example of the problem faced by MNEs in negotiating detailed national rules is the sales invoice. As the basic business document that accompanies all business-to-business (B2B) transactions, invoices play a vital role in accurate financial reporting. MNEs themselves want to ensure that their invoices report accurately what has been sold to whom, when and where, and the amount due.

Surely this is an area where taxpayers’ and tax administrations’ interests coincide? If vendors, purchasers and tax collectors need the same basic information, MNEs could lighten their day-to-day compliance burden by adopting standardized invoice formats across different countries. But the reality is far less rosy. In our survey of the VAT invoicing requirements in 90 countries, we found widely differing national requirements that make it difficult to use a standard sales invoice document and a standardized invoicing process.

One of the most onerous local requirements for MNEs that use shared service centers is the need to issue an invoice in the local language and in the local currency. Another factor adding to complexity is the lack of standard requirements. Invoicing deadlines around the world, for example, range from no days to one year after the time of supply (see figure 1). In 19 of the countries we surveyed, the taxpayer must use an invoice generated by the tax administration or pre-approved by it in some way, and in 5 countries, invoices must be issued on colored paper. In 31 countries, it is obligatory or advisable to sign invoices before they are issued; in 24 countries, it is obligatory or advisable for invoices to bear the company stamp; in 50 countries, it is obligatory or advisable to add legal language if no VAT is charged (e.g., citing the relevant legislation); and in 57 countries, an exemption certificate is advisable or required from a customer who requests VAT exemption based on its status.

The result of these wide variations, in practice, is that it is virtually impossible for a global company to design something as fundamental to its day-to-day business operations as an invoice that works all over the world.
Compliance burden – invoicing obligations

Figure 3: Invoicing obligations – use of tax administration invoice
Source: Ernst & Young

Figure 4: Invoicing obligations – company stamp
Source: Ernst & Young

Figure 5: Invoicing obligations – addition of legal language if no VAT charged
Source: Ernst & Young
The VAT Director of an MNE operating in more than 100 countries discusses the difficulty of adopting a standard VAT invoice globally:

“Our mantra for efficient processes is ‘standardize, digitize, globalize.’ The issuance of a tax invoice is really the same process in every country. What changes is the data elements on those invoices. If you think practically about how you would make a VAT work, the tax invoice is a central document. We are familiar within our core markets in the EU, for example, that there is probably a list of, let’s say, 20 things that go on at tax invoice. That is, the same 20 things in all the EU countries. We are seeking to compile that list the world over because if we can then see that it is really the same 20 things, we can then say ‘OK, if we build a generic invoice template, it is probably going to apply to the world over.’”

“The exceptions to that of course are those countries where other laws and rules impinge on us. From a very narrow VAT perspective, we could be equipped to issue that standard invoice out of a standard ERP or invoicing system and do it from one place centrally, efficiently and meet our global needs. However, the other sorts of laws that will catch you out are usually corporate laws, local accounting laws, local laws on books and records and local laws, let’s say, that invoices have to be signed or rubber stamped.”

“We can issue the same commercial invoice in pretty well every country in the world. The contract terms of what would be billed, the currency, the frequency with which we will invoice — all that is agreed upfront. The bit that we are trying to then address is: how do you convert all that commercially agreed stuff into what the tax law or the bookkeeping law in the country actually requires? Supplier and customer know exactly what’s going on because that’s what they contracted. But how do the two parties then shoehorn that into their books and records such that it complies with the bookkeeping requirements of the local country concerned or the tax law?”

The Global VAT Director of a large financial institution comments on the practical difficulties that short reporting deadlines pose for complex organizations:

“What would make my life easier? Longer filing periods. That would give us a better chance to get it right first time. Also a greater attempt by tax administrations to understand what their theoretical rules mean in practice for large organizations that want to pay the right amount of tax, with willingness to agree a pragmatic ‘Plan B’ where global accounting systems deliver accurate results but don’t fit exactly with local rules.”
“There has been considerable overall progress in the use of e-filing for the major taxes and a number of bodies can report substantial progress over the last five years. For many, this progress has been facilitated by the use of mandated e-filing requirements (e.g., CIT, VAT and employers’ wage income reports). However, around 30% of surveyed revenue bodies still have considerable progress to make across some or all of the major taxes, including a number who have made quite limited progress over the last five years.”

The Organisation for Economic Cooperation and Development Survey of Trends and Developments in the Use of Electronic Services for Taxpayer Service Delivery March 2010

VAT returns and payments

Companies that are registered for VAT in a number of jurisdictions or MNE groups that use shared services centers must also contend with different VAT reporting dates and the widely different formats used for VAT returns.

For large companies, VAT return periods vary from monthly (most common) to bi-monthly, quarterly and bi-annual. In addition to periodic filings, 19 countries also require annual returns and 2 countries require interim payments on account. EU countries also require statistical information (INTRASTAT) returns and sales lists for taxpayers engaged in cross-border trade within the EU.

VAT return submission dates range from 10 days to 2 months after the end of the return period. Payment of any return liability is generally required at the same time.

Although the majority of countries provide for electronic submission of returns and payments, over a third still use paper forms (31) and nearly a third require payment by cheque (28). All but four countries require the VAT return to be signed in some way. These requirements can add greatly to the practical difficulties for companies that prepare and submit their returns from outside the country.

![Figure 6: VAT return format and method of payment](source: Ernst & Young)

![Figure 7: VAT return frequency](source: Ernst & Young)
In the oil and gas industry, we often have chains involving hundreds of counterparties. Under the current rules, they all need to register for VAT everywhere; it’s so inefficient and the risk of getting things wrong is very high.”

The VAT Manager of a European oil company

Accurate VAT reporting for global activities can be made more difficult by the complexity of VAT legislation (for example, the complex rules connected to supplies of cross-border services) and the difficulty of applying the rules to all the types of activities that multinational organizations undertake.

Even with the best efforts, honest errors may arise about the classification of a supply, especially for activities that are taxed in different ways in different countries. In some cases, taxpayers may need to rely on information provided by third parties, such as customers, which may be difficult to verify. This is the case, for example, for deciding where VAT is charged for a host of cross-border services under the new EU 2010 VAT package rules. In other cases, genuine uncertainty may exist about the correct VAT treatment of a transaction and whether, where and even when VAT is due.

We surveyed Ernst & Young VAT professionals in 40 countries and asked for their subjective views about the quality of the relationship between taxpayers and the tax administrations in their countries and on ways to improve that relationship.

Uncertainty may lead to errors and disputes with tax administrations, and matters, can quickly escalate. In many countries, penalties relate to the number of incorrect invoices issued, irrespective of the impact of the error on the revenue. Large penalties may accrue even for minor mistakes or where there is no net tax lost. Tax administrations in 29 of the 40 countries surveyed provide binding rulings, but 11 countries do not; 22 countries impose a penalty where errors are made but there is no tax loss, 7 of which do not give taxpayers access to formal rulings.
Voluntary disclosures

Many MNEs actively review their VAT compliance processes and discover VAT accounting errors that are not identified during tax audits. The 40 countries we surveyed on this issue differ in their approaches as to whether penalties apply to errors voluntarily disclosed by taxpayers. In many countries, taxpayers receive some incentive to voluntarily disclose by way of reduced penalties. In 2 countries, no penalty or interest applies in these circumstances, and in 4 countries, a penalty applies but no interest is due, while in 18 countries, no penalty applies but interest is charged. However, in 16 countries, a penalty plus interest applies under the legislation, which seems to provide little incentive for taxpayers to disclose errors. In practice, however, tax administrations in many of these countries may reduce or mitigate penalties in certain circumstances.

The taxpayer/tax administration relationship

Does the VAT compliance burden have an impact on the relationship between taxpayers and tax administrations? We surveyed VAT professionals from 40 countries in the Ernst & Young Indirect Tax network. We asked them to subjectively rate the quality of the relationship between large corporations and the tax administrations in their countries on a scale of 1 to 10 – with 1 being “very poor” and 10 being “excellent.” The average score of their responses was just under 6, with more than half of the respondents answering 5 or higher. Generally, Ernst & Young’s VAT professionals feel there is a good relationship between taxpayers and tax administrations in their countries, which is encouraging. However, as only one country gave a rating of 9, and several countries awarded a mark of 3 or 4, there still seems to be room for improvement.

Is the relationship between tax administrations and MNE taxpayers influenced by aspects of the compliance burden? Obviously we need to be wary of drawing conclusions based on the small sample size and subjective ratings, but the survey responses do indicate some possible areas for further consideration.

The existence of binding rulings did not seem to greatly influence the relationship in the countries surveyed, perhaps because rulings are available in the majority of countries. Surprisingly, the application of a penalty to errors where no tax is lost also seems to have little influence. Perhaps, again, this is because the majority of countries do impose a penalty in these circumstances. However, the relationship does seem to be affected in countries where voluntary disclosures of errors are subject to a penalty plus interest, rather than to no penalty or to either a penalty or interest.

The frequency of VAT audits also seems to be a factor, with countries where VAT audits happen once a year or more frequently tending to show a lower relationship rating than countries where visits happen less often. However, the impact on the relationship may depend on what happens at tax audits, whether they are used to scrutinize formal errors or to build a relationship that allows the taxpayer to improve its VAT compliance performance.

The length of time that disputed tax cases take to be resolved at the lowest and highest courts may also be significant. The countries that indicated better relationship scores tended to resolve tax disputes at the lowest court within three years and at the highest courts within six years.
Tax administration viewpoint

Prenesh Ramphal, Senior Manager of VAT Research and Development, South African Revenue Service (SARS) talks about the VAT alignment in Africa:

“We belong to the Southern African Development Community (SADC) which is a group of African countries, and a current topic of discussion at the Indirect Tax Working Group is the alignment of VAT between SADC countries. It is not referred to as VAT harmonization as envisaged in the EU. For example, Lesotho and South Africa have VAT that is very similar. Both countries have entered into a bilateral agreement which provides in terms of the respective countries’ VAT legislation that both countries can enter into a tax agreement for the purposes of refunding VAT between countries and ensuring that there is no double taxation and non-taxation.”

“In terms of the refunding arrangement there is only one document that is recognised to validate a refund, namely a tax invoice which both countries have acknowledged to be proof of the output tax as well as the input tax. So the implementation of separate documents in terms of the two sovereign VAT laws of the two countries is not an issue. For example, the tax invoice issued in South Africa can be used as proof to claim input tax by a Lesotho VAT registered business.”

“This is a typical case of alignment but it’s not harmonization because the countries also have maintained the sovereignty of its VAT legislation.”

Insight

Tax audits:

The Global Indirect Tax Director of a tobacco company with operations in more than 130 countries on the impact of tax audits:

“When we have an audit, it helps us as an organization to think about ourselves. Because when a tax audit is announced, we perform an internal review of the entity, etc. to see if there are any issues. So in this sense, I do not say that a tax audit is bad, I think a tax audit is good. Of course if you can avoid them, it’s good too! Because for us, a tax audit is also a lot of work.”
Aspects of compliance
The taxpayer/tax authority relationship

Figure 12: Quality of the taxpayer/tax administration relationship – availability of rulings (on a scale of 1 to 10)
Source: Ernst & Young

Figure 13: Quality of the taxpayer/tax administration relationship – application of penalties (on a scale of 1 to 10)
Source: Ernst & Young

Figure 14: Quality of the taxpayer/tax administration relationship – application of penalty to voluntary disclosures (on a scale of 1 to 10)
Source: Ernst & Young
Figure 15: Quality of the taxpayer/tax administration relationship – frequency of VAT audits (on a scale of 1 to 10)
Source: Ernst & Young

Figure 16: Quality of the taxpayer/tax administration relationship – time needed to resolve VAT disputes (on a scale from 1 to 10)
Source: Ernst & Young
Living with a complex world

Improving VAT compliance performance

We asked selected tax directors and VAT managers of MNEs about their experience of managing multinational VAT registrations and how they meet their VAT compliance obligations in today’s complex business environment.

As we have outlined, the multinational VAT compliance burden can weigh heavily on MNEs. Undoubtedly their burden would be reduced if VAT systems could be simplified and harmonized across jurisdictions. However, it is also true that many MNEs could take practical steps to improve their multinational VAT compliance performance. In the current compliance climate, MNEs may need to assess their global VAT needs strategically, while taking local needs into account.

Appropriate measures may include reviewing, modifying and monitoring VAT compliance processes, standardizing return processes and documentation, increasing automation, increasing oversight, improving staff training, actively monitoring VAT changes and outsourcing compliance functions.

Insight

The Global Indirect Tax Director of a tobacco company with operations in more than 130 countries:

“The most difficult country for us to deal with overall is Brazil because of the multiplicity of indirect taxes with a different interpretation in every state. Having just one legislation and one interpretation would be a good starting point to making our lives easier there. The easiest countries for us to deal with are Germany and the UK. In the UK, it’s because we have a good relationship with the tax administration built up over many years.”

“In Germany, it’s because the tax administration is very straightforward and clear. They do what they say. So even if we don’t necessarily like what they say, at least we have certainty about what it is. A good relationship with the tax administration wherever it may be always helps us to manage our level of risk properly. If the rules are clear, it’s easier to understand and apply them correctly.”
“No penalties if there’s no tax loss. That would be heaven if we could get to that situation.”

A Global Indirect Tax Director

Insights

The VAT Director of a diverse MNE group operating in more than 100 countries discusses an ongoing project designed to achieve 100% VAT compliance for the company globally:

“The project generally is focused on one of our businesses but there are clearly aspects of what we are learning that can be borrowed across the rest of our company portfolio. The initiative really has arisen because we are a global business. We are in all these different territories and jurisdictions around the world struggling to comply with all the local rules everywhere.”

“We want to try to standardize our approach, digitize that approach and then globalize it. Because once you do have a standard way of doing things and you have managed to put it into business systems, ERPs, etc., you then have the ability to scale it globally into all your operations. If you can completely harmonize across branches, you drive tremendous efficiency because that gives tremendous economies of scale and consistency because effectively you are operating to one system. That’s part of the motivation here. But our branches are in different countries and are subject to different rules. We can standardize 80%; the 20% gets difficult.”

“There is also our corporate culture which is to protect aggressively, where necessary, the company’s reputation. We do set great store by complying with all the rules all the time in all the places. There is no halfway house; either you are compliant or you are not. That clearly covers everything, not just tax but everything. That’s definitely part of the cultural approach here as well.”

“And let’s not be bashful. We have had our knuckles rapped in a couple of places where we have gone into an audit and come out a few pounds lighter. We paid our fair dues where we got it wrong. But once bitten, twice shy.”

The Senior Tax Manager of a large energy company based in The Netherlands:

“We have a shared services center in The Netherlands; they do the compliance for the Dutch company and for its foreign VAT registrations. Our biggest difficulty in dealing with the foreign registration is being very well informed about all the changes in the legislation. You always depend on your advisors and luckily we are very well informed, but it’s a constant challenge.”

“As a Dutch company, we are used to discussing things with the tax administration. And even if you have done something wrong, which happens from time to time, there is always the willingness to deal with things practically – especially if there is no actual VAT loss, which is usually the case. Therefore, for companies that are proactive and spot things themselves, there is an incentive to put things right.”

“What I would like to see in other countries is that you can approach the tax administrations more easily and have your own inspector who is on your case. But that means that both parties have to let down some parts of their guard. Each one should have a fair position. The tax administration should definitely get a fair payment of tax. But if we report a difficulty, the tax administration should be practical and go light on some other formalistic stuff.”

“We already talk a lot upfront in The Netherlands with the tax administration. We are also considering a formal ‘horizontal monitoring’ arrangement. We want that because we want to have certainty. Preparing for that requires us to put our house in order. But I would say it is good for our business. We can use the process to first investigate our own risks and to get in control ourselves. If we can show to the outer world that we have certainty on certain topics, that we are ‘clean,’ there is an added value in that.”
Stephen Bill, Advisor to the Director General for Taxation in the European Commission, talking at the Ernst & Young 2010 Indirect Tax Symposium in Budapest, outlined ways that governments and honest taxpayers may work together to reduce the VAT compliance burden:

“Organized fraud has become a particular problem within the EU largely as a result of the system for dealing with intra-Community supplies of goods between businesses (B2B). As a result, we have embarked on a short-term anti-fraud policy within the EU which has, unfortunately, resulted in increased compliance costs for honest traders (for example, by requiring more frequent reporting of intra-community supplies). Increasing the compliance burden is never a good thing and it is particularly regrettable at a time when we are seeking to make tax systems more ‘growth friendly.’ The major imperative for tax policy-makers is now therefore the search for a ‘win-win’ situation in which administrative burdens and compliance costs can be reduced while at the same time safeguarding tax revenues.”

“I think there are a number of potential avenues to explore here. First is creating tax partnerships. Our discussions with business have shown recognition of the need to improve communication between taxpayers and tax administrations and the need to establish a relationship of trust which could lead to reduced compliance costs for participating traders. One obstacle, however, could be the principle of equal treatment of taxpayers (laid down in the constitution of some Member States).”

“An increased use of new technology could also help. Increased e-invoicing, for example, could in turn lead to increased use of less intrusive e-audits. The generalized use of electronic registration and tax return filing also could reduce compliance costs for traders operating in more than one Member State. In my opinion, it will be essential to ensure that tax collection and administration uses modern technology to the utmost to reduce compliance costs as much as possible, particularly for cross-border activities since the internal market will be a cornerstone for stimulating growth in Europe. I firmly believe that we should develop the concept of the one-stop-shop so that it could be used for all intra-community supplies. It could even in the longer term be used as a mechanism to tax all B2B supplies of goods.”

“There are also some ideas circulating about the possibility of using financial intermediaries (banks and credit card companies) as trusted third parties to collect and remit VAT paid on transactions between taxable persons.”

“Following the adoption of the VAT package and the completion of the work on the short-term anti-fraud package of measures, we are now at a watershed in the EU. We now need to identify what common VAT system we want in the 21st century and, in particular, how we can obtain the elusive ‘win-win’ in Europe.”

“This process started already in the EU with the 2008 VAT Fraud Communication which initiated reflections on the use of new technologies and the relationship between taxpayers and tax administrations. As a follow-up to this, a conference was held in Amsterdam with stakeholders, and the Commission has initiated a study on ‘simplifying VAT collection through new technologies.’ The idea will then be to launch a wide-ranging consultation – kicked off with a Green Paper identifying problems and expecting solutions before finalizing a new strategy in 2011. The new strategy will build on the four pillars of the existing VAT strategy (launched in 2000): simplification, modernization, more uniform application and closer administrative co-operation.”
A recent OECD conference\(^8\) recognized the practical difficulties that VAT legal systems face in a globalized economy. Several speakers approved of simplification proposals, such as an easing of the documentary requirements needed to support transactions and the introduction of a single VAT rate. Do these reforms have an impact? What are other ideas could improve the VAT system for the benefit of MNE taxpayers and tax administrations?

We solicited feedback on reducing the multinational VAT compliance burden and improving the taxpayer/tax administration relationship from our Ernst & Young Indirect Tax network of VAT professionals, and from selected tax directors of multinational companies and tax administration officials. We report on their suggestions for improvements and the “wish list” of changes that tax directors believe would improve their multinational VAT compliance performance. The comments accord with the OECD’s Taxation Framework Conditions\(^9\), a set of broad principles that the OECD believes should apply to electronic commerce (sometimes referred to as the Ottawa Framework).

**Neutrality**

Everyone we interviewed agreed with the OECD framework that “business decisions should be motivated by economic rather than tax considerations.” However, many interviewees felt that this is not being achieved in practice. Several VAT directors expressed concern that business decisions in their organizations are currently being influenced by factors related to VAT compliance, such as the desire to avoid foreign VAT registrations or incurring irrecoverable VAT. Several taxpayers noted that it is more difficult for non-resident VAT taxpayers to deal with detailed local compliance requirements.

Suggestions for improvement in this area included:

► Extension of arrangements for refunding foreign VAT
► Simplified foreign VAT refund procedures
► Faster foreign VAT refunds
► Harmonization of VAT rules for cross-border trade to avoid double taxation

**Efficiency**

Minimizing compliance costs for taxpayers and administrative costs for the tax authorities was also an issue addressed by the taxpayers, tax administrations and VAT professionals we interviewed. Many organizations are using shared services centers to meet their multinational VAT obligations, which increases operational efficiency but may increase tax risk. Suggestions for improvement in this area included:

► Harmonization of VAT rules
► Harmonization and standardization of VAT reporting obligations (including a single EU VAT return)
► Harmonization and standardization of VAT invoicing obligations and invoicing format
► Harmonization of VAT rules for cross-border trade to avoid double taxation
► Consistent VAT treatment between EU countries
► Longer filing deadlines to allow taxpayers to “get it right the first time”
► Adoption of monthly invoicing and e-invoicing regulations
► Increased use of reverse charge accounting to avoid foreign VAT registrations and VAT cash flow impacts
► Extension of the EU “one-stop-shop” VAT registration concept beyond electronic services (to reduce the number of VAT registrations)

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\(^8\) OECD High Level VAT Conference, Lucerne 9–10 September 2009
\(^9\) Electronic Commerce: Taxation Framework Conditions OECD 1998
Certainty and simplicity
The OECD framework sets out that VAT rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of a transaction, including knowing when, where and how to account for tax. This principle seems to resonate strongly with the taxpayers and VAT professionals we interviewed. They all cited certainty and simplicity as key factors in improving the relationship between taxpayers and tax administrations.

Suggestions for improvement in this area included:
► Simplified VAT systems (fewer exceptions, fewer rates, etc.)
► Consultation before legislative changes
► Clearer VAT legislation
► More published guidance
► Greater legal certainty through clearer, simpler legislation, advanced rulings
► Clearer, more consistent EU policies and fewer derogations from EU directives
► More dialogue between taxpayers and tax administrations
► Tax administrations to announce changes well in advance to allow taxpayers sufficient time to implement them (to implement contractual changes, educate staff and business partners, adapt ERP systems, etc.)
► Fewer formal VAT requirements
► Simplified procedures for chain transactions involving more than three parties to reduce foreign VAT registrations

Effectiveness and fairness
The OECD framework states that “taxation should produce the right amount of tax at the right time. The potential for tax evasion and avoidance should be minimized while keeping counteracting measures proportionate to the risks involved.”

Suggestions for improvements in this area include:
► More training for VAT auditors
► The development of a closer taxpayer/tax administration relationship through programs based on open disclosure
► Lower VAT penalties, especially for voluntary disclosure
► No penalties for no VAT loss
► Light-touch regulation for compliant taxpayers

Flexibility
The OECD framework states that “the systems for taxation should be flexible and dynamic to ensure that they keep pace with technological and commercial developments.”

Suggestions for improvements in this area include:
► A more pragmatic and realistic approach by tax administrations
► Greater use of technology for multinational VAT obligations (such as increased use of e-filing and electronic payment)
► Acceptance of alternative forms of documentation as evidence (such as commercial documents rather than formal invoices)
Prenesh Ramphal, Senior Manager of VAT Research and Development, South African Revenue Service (SARS), talks about aspects of tax administration help to improve the taxpayer/tax authority relationship:

“On the corporate side, I would say SARS has a generally good relationship with taxpayers. I’m glad to say that SARS does engage and affords appropriate attention to the issues coming out of the stakeholder engagement forums. We have a good public participation process in the tax legislation proposals, which has its roots in our Parliamentary Budget tax proposal announcements. Issues relating to Tax Policy are publicly shared inviting participation with SARS.”

“Our Large Business Centre monitors trends of taxpayer behaviour within the various business sectors. If a material deviation is noted, the taxpayer relationship manager interacts with the tax manager in that particular corporate in order to establish reasons for that deviation. This is to get a feel of what’s going on without necessarily scrutinising the books of account. SARS therefore does not overburden the corporates with requests for audit, but try and maintain a level of risk profiling that provides information which can be re-acted to. In that respect there is already a light touch approach on a corporate taxpayer. The risk is determined without actually imposing on corporate's the burden of perpetual audits. There are instances, of course, where corporates are identified for a full VAT audit which usually occurs due to the high risk nature.”

“We also have minimal instances of VAT disputes which are taken to litigation. We also have an alternative dispute resolution process which means a tax dispute can be resolved without the need to formally litigate. I think that also helps in reducing the VAT administrative burden and the associated costs of litigation.”

“Unless it’s a case of fraud or deliberate underpayment, most taxpayers can opt for an alternative dispute resolution process. The majority of the taxpayers, in my view, will seek to come to a resolution on the matter. The two parties, through a facilitator will attempt to resolve the issues at tax administration level. Dispute cases are resolved more quickly as well. Issues pertaining to tax principle and issues of fact, are generally not referred to alternative dispute resolution. Majority of the dispute cases follow the route of alternative dispute resolution process – because both taxpayers and SARS see the benefits of the process.”

“We also have a VAT ruling regime that provides certainty and clarity in respect of the application of the legislation. SARS has two types of rulings regimes. The first one is the advance tax ruling where for example, corporate wishes to enter into a multinational contract and can obtain certainty and clarity in advance on the tax implications of that contract. This ruling binds SARS. There is an application fee and a cost recovery fee based on time spent by a tax specialist on the matter. The second rulings regime is for historic transactions which a taxpayer may require for purposes of self assessment and disclosure to SARS. We also have a standard turn-around time within which an applicant can expect a ruling to be issued. Corporate's find these ruling regimes to be effective and efficient.”

“Experience shows that taxpayer engagement is important in order to obtain all the facts so that the ruling issued will not cause distress to the taxpayer.”
The Senior Tax Manager of a large energy company based in The Netherlands:

“What I would change? I would like see all the EU countries stick to the EU VAT Directives with no freedom to implement certain rules in certain cases – to have one general rule and no differences with other countries. There is no one European legislation, for example, for what we do with certain commodities, but our activities are treated differently for VAT between different EU countries. There are differences on derivatives, emissions, virtual storage and real storage. For example, gas storage in one country is treated as X and in another country as Y. So sometimes it is hard to know what to do.”

“And of course, non-EU countries treat them all differently too, such as Norway. But that is non-EU and you have to deal with those countries individually. Although sometimes those countries do try to align to the EU rules, for example, they also changed their rules for power and gas trading.”

“What you would almost like to have is some direct EU VAT arbitration panel which could immediately give guidance on these differences in interpretation in the legislation itself; a panel of “wise men” who would get the individual tax administrations in line with what is actually intended by the EU Directives. It is not so much that you can’t argue about it, but the treatment between the Member States should be the same. I mean if everyone charges VAT it is also a right. It is usually the difference between the countries that actually makes it really hard.”

The Global Indirect Tax Director of a tobacco company with operations in more than 130 countries talks about how staff training is crucial to helping his team meet the challenge of maintaining accurate VAT reporting in a fast-moving business environment:

“Our biggest indirect tax compliance challenge is mapping and updating the supply chain in our ERP system and seeing that our people are trained. We have trained a huge list of people this year who could affect our VAT position. That includes our VAT compliance teams, of course, the finance people who deal with the VAT returns, our accounts payable team who deal with processing purchase invoices and coding them and our supply chain team who make decisions on which plants are producing for which market. Then we have our purchasing organization which consists of several departments for services and for goods – such as our leaf operation which purchases tobacco leaf globally and ships it around to our different factories. So that’s lots of business functions that we are training, not only in VAT, but also in customs and excise. This training is technical but the ultimate objective is more to create an awareness of indirect tax issues we may have to face. My centralized tax team is also there to support to solve some VAT issues, and answer questions, provide oversight and so on.”

“We are seeing great benefits from this training program. People in the business are very open to our comments and concerns, so indirect tax is not set aside as a business stopper; instead, we are seen as an enabler for the business. But, of course, it requires a lot of time, effort and resource and it’s an ongoing commitment.”
Shane Reardon, Deputy Commissioner, Goods and Services Tax (GST) of the Australian Tax Office (ATO), discusses how the administration is seeking to forge a closer relationship with large GST taxpayers and outlines the potential benefits for both sides:

“For large corporate taxpayers – I’m talking about taxpayers with turnover of over A$250 million a year – we offer what’s called an annual compliance arrangement (ACA) whereby the corporate gets significant benefits from us in terms of voluntary disclosures and penalty and interest concessions, speedier turn-around time on advice and more certainty for the prior year tax position, in return for a relationship that is based on full and true disclosure. It is based on the Commissioner being satisfied that the corporate itself has good tax risk management and governance processes in place as a matter of course and that we are satisfied with those governance processes. For example, the corporate would alert their board or the management to major tax issues as a matter of course. In return, we would adopt a relationship that isn’t based on audit, but is based on an assurance-based process, knowing that the taxpayer will disclose any issues to us. On that basis, we would work together to resolve any issues and reach agreement on the tax treatment and this would include concessions when it came to penalties and interest. Full and true disclosure also operates the other way so the Tax Office would be required to provide disclosure of information that was relevant to the corporate as well – for example, we would inform the corporate of any emerging GST risks and issues that would apply to their relevant market or industry.”

“We then appoint a relationship manager to work with someone from the corporate, generally from their tax management area or their tax unit. For the annual compliance arrangements we’ve got in place, there is basically pretty consistent dialogue and exchange between the corporate and the Tax Office. These exchanges occur not in an audit environment but in a relationship environment. We’ve only got a handful of taxpayers who have signed up to this arrangement for the moment so we are still working through some issues around marketing and implementation but, generally, the taxpayers who are involved are actually quite satisfied with the arrangement and believe it does represent value.”

“There are also advantages for the tax administration of having this kind of relationship with taxpayers. It allows us to focus our resources more effectively. It is a long way from the ‘hide and seek’ relationship of the past. Of course, we still examining issues and transactions, and we monitor compliance at a macro level pretty well. The audit program is a significant part of what we do, but we also know that on its own, it will not get us to where we want to go.”

“We want to create an environment where corporates can easily do the right thing and meet their obligations. That is the advantage that the ACA gives. It is built on a mutual trust. Because we’ve got a letter from their CEO or CFO we trust they’ve got good systems in place, we trust that they’re going to fully disclose to us issues that they should and equally they trust that we’ll keep our word in terms of disclosing issues to them, providing certainty, delivering high quality and timely service and also providing the concessionary approaches when it comes to interest, penalties and the treatment of mistakes. One ACA participant was contemplating a transaction and treating it a certain way; they talked to us upfront about it, we gave them advice and they treated the transaction in accordance with our advice, which they might not have done without the ACA. This lets us focus on making the open relationship environment very real and tangible, where corporates are given the right advice at the right time and the transparency of the relationship is strong, and we can be assured that the GST revenues are being paid as they should be paid.”
Where to from here?

The VAT complexity faced by MNEs leads to uncertainty, errors, disputes and increased cost. For companies, 100% VAT compliance seems at best very costly and at worst impossible. The current situation, based heavily on local rules, is also damaging to tax administrations, which are experiencing unprecedented calls on their scarce resources in collecting vital tax revenues and preventing tax fraud. We believe that reducing the compliance burden can improve VAT compliance performance by the largest VAT taxpayers, thereby protecting vital tax revenues as governments address budget deficits.

All parties have a role to play. MNEs need to take their multinational VAT compliance obligations seriously. Multinational VAT compliance must remain a management priority. All over the world, MNEs must continue to devote resources to keeping abreast of developments that affect their VAT position training staff and adopting adequate VAT accounting processes and controls, in recognition of the large volumes of VAT revenues that flow through their accounting systems.

At the same time, tax administrations need to address MNEs’ legitimate concerns about the burden of multinational VAT compliance, which increases costs, creates high levels of tax risk and has an adverse effect on their business operations.

We believe that individual tax administrations, trading blocs, such as the EU, and international organizations, such as the OECD, should make multinational VAT reform a priority. This is a pressing issue as globalization continues apace. We applaud the work of the OECD in producing Draft VAT Guidelines aimed at bringing clarity and consistency to the VAT treatment of cross-border activities. We also commend the continuing efforts at harmonization and simplification undertaken by the EU, including programs related to e-invoicing and the extension of the “one-stop-shop” regime for foreign VAT registrations. We hope that other countries in Europe, such as Switzerland and Norway, continue to align their VAT legislation with the EU where practicable. We would also encourage greater regional cooperation on VAT legislation and administrative practice in other regions of the world, such as the Americas, Africa and Asia Pacific.

We would also like to see MNE taxpayers and tax administrations enter into closer, more open relationships based on trust and transparency. This may be achieved both through informal changes in attitude and through formal programs. Examples around the world include the use of binding rulings, taxpayer guidance, the use of new technology to allow taxpayers to fulfill their obligations remotely, the allocation of designated tax inspectors and the introduction of programs such as “horizontal monitoring” in The Netherlands and the ATO’s ACA program in Australia, which encourage taxpayers to adopt robust processes and disclose errors, in return for “reduced penalties” and “light-touch” oversight.

MNE taxpayers and tax administrations all have much to gain from greater multinational simplicity, harmonization, clarity and fairness in the VAT system — reduced costs, less tax controversy, better use of scarce resources and improved VAT compliance performance. Achieving 100% VAT compliance may no longer be an unattainable dream.
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