Roadmap to tax function effectiveness and certification of VAT Control Framework

Concrete actions for change

By Richard H. Cornelisse

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How it all started

First, the benchmark surveys results are alarming:

- Senior management and external auditors often considering indirect tax not material and a high priority
- The low risks qualification of indirect tax likely results in budget constraints
- Lack of specific VAT/GST measurable performance goals visible to the CFO
- Lack of proper prioritization between lower value activities and higher value activities
- Indirect Tax function has many competing priorities and insufficient time or resources
- Historically, the tax function in general focused on other areas, allowing other departments and local offices a free hand to deal with the company's indirect taxes
- In most companies Finance and Accounting is accountable for indirect tax
- It seems that the (indirect) tax department is often the last to know what is going on, is forced to be the show stopper when other parts of the business thought they were are ready to ‘go live’

If indirect tax risks are truly that high, then shouldn’t it receive more attention from the CFO?

*The surveys of the Big4 are clear: we are talking about extremely large amounts of money that lack appropriate control, but because KPIs have never been developed for this particular purpose, the risks remain outside the CFO’s field of view.*

The fact that direct and indirect tax work in a different way must also be taken into account. The Head of Tax should be more involved in the indirect tax function.
The Head of Tax mainly gets his information from corporate finance and not so much from other departments. And that is precisely where the indirect tax is managed and must be operated. It is therefore often not visible for the Head of Tax how important the controls on indirect tax are.

If the Head of Tax and the Indirect Tax Function would figure out how to cooperate more efficiently, they will also bring indirect tax more into the spotlight of the CFO.

*The aim of this book is to provide guidance to realize VAT function effectiveness and what actions should be taken to make that happen.*

**About the author**

Richard advises multinational businesses in improving the efficiency and effectiveness of their Indirect Tax Function and Tax Control Framework.

He started his career as a manager at Arthur Andersen and then became a partner in EY where he led the indirect tax performance team for Netherlands and Belgium. Currently he is a managing director of the Key Group.

Richard has over 20 years’ experience advising clients on international VAT issues. He is specialized in the tax aspects of financial transformations, shared service centre migration, and post merger integration work.

Richard is also somewhat of a mentor, giving back to the profession. If you are interested in conversation and discussion, please feel free to contact him.

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My own road trip

At Andersen around 2000, we discovered that our previous advice given about VAT cash flow optimization was wrongly implemented in the ERP system resulting in a cash flow disadvantage for many years. That was my eye opener and was actually the reason that I set up as one of the first a team with a focus on ERP and indirect tax solutions.

The Andersen team continued when we moved to EY. We branded the service offering in 2002: 'ISIS' (Indirect tax Solutions for Information Systems). In hindsight not really a good name.

VAT ERP remains still an important VAT critical process to manage, however it is only one of the building blocks of indirect tax function effectiveness. This publication takes it a step further as all of the key building blocks are addressed and discussed but also the 'Why', 'What' and 'How' are explained to realize function effectiveness. It should and has as aim to facilitate in-house benchmarking.

Benchmarking provides objective evidence. It can show whether or not you have achieved your objective set such as a 'mature' tax function' or make visible what needs to be done to make that happen. It might provide the extra arguments to realize change and get buy-in.
Acknowledgements

In writing this e-book I have drawn also expertise and experience of many specialists. In particular I like to mention Edwin van Loon and Kathy Downs. I have had the privilege to work with them both at EY and we have published 'thought leadership' articles in tax literature together. The startpoint for writing this e-book.
Towards a new and definitive VAT system for the EU

The Commission adopts new proposals for the most far-reaching VAT reform in the EU for a quarter of a century VAT is a major and growing source of revenue in the EU, raising over €1 trillion in 2015, corresponding to 7% of EU GDP.

However, despite many reforms, the VAT system has been unable to keep pace with the challenges of today's global, digital and mobile economy. The current VAT system dates from 1993 and was intended to be a transitional system.

According to the Commission's proposals, VAT will now be charged on cross-border trade between businesses. Currently, this type of trade is exempt from VAT, providing an easy loophole for unscrupulous companies to collect VAT and then vanish without remitting the money to the government.

Overall, over €150 billion of VAT is lost every year, meaning that Member States miss out on revenue that could be used for schools, roads and healthcare. Of this, around €50 billion - or €100 per EU citizen each year - is estimated to be due to cross-border VAT fraud. This money can be used to finance criminal organisations, including terrorism.

It will be simpler for companies that sell cross-border to deal with their VAT obligations thanks to a 'One Stop Shop' (OSS).

Traders will be able to make declarations and payments using a single online portal in their own language and according to the same rules and administrative templates as in their home country.

Member States will then pay the VAT to each other directly, as is already the case for all sales of e-services.

The Commission also proposes a move to the principle of 'destination' whereby the final amount of VAT is always paid to the Member State of the final consumer and charged at the rate of that Member State.
The proposal foresees a simplification of invoicing rules, allowing sellers to prepare invoices according to the rules of their own country even when trading across borders.

Companies will no longer have to prepare a list of cross-border transactions for their tax authority (the so-called 'recapitulative statement').

The proposal introduces the notion of a 'Certified Taxable Person' – a category of trusted business that will benefit from much simpler and time-saving rules.

The legal cornerstones of the definitive VAT system

The legal cornerstones of the definitive VAT system. They include, in particular, the introduction of the principle of taxation in the Member State of destination and of the liability of the supplier as a rule (except where the customer is a certified taxable person).

They also introduce an One Stop Shop (OSS) that would allow suppliers to account for the VAT due on their supplies of goods to other Member States in their Member State of establishment. This OSS would allow offsetting output VAT due on supplies made against input VAT incurred on purchases made within the EU.

The concept of Certified Taxable Person does not currently exist in EU VAT legislation but would be introduced as part of the definitive VAT system.

Both for the definitive VAT system and also as regards certain of the aforementioned improvements to the current system taxable persons should be able, under certain conditions, to obtain the status of a certified taxable person (CTP).

*The concept of certified taxable person should allow for an attestation that a particular business can globally be considered to be a reliable taxpayer.*
Certain simplification rules related to call-off stock arrangements, chain transactions and the proof of transport of goods transported or dispatched to another Member State which could be fraud-sensitive, should apply only where certified taxable persons are involved in the relevant transaction.

The certified taxable person concept should in addition allow for a gradual implementation of the definitive VAT system because during the first step of that definitive system reverse charge would apply where the acquirer, in case of intra-Union supplies of goods, is a certified taxable person.

The justification is that, the certified taxable person being by definition a reliable taxpayer, no fraud should occur as a result of VAT not being charged on intra-Union supplies of goods made for a certified taxable person.

In this context, it is essential for businesses and tax administrations that the certified taxable person status of a business can be checked immediately and online.

To that end, it is necessary that all Member States store information on businesses and their certified taxable person status in an electronic system and that the competent authorities of each Member State ensure that confirmation is provided of the certified taxable person status of any business.

Issues related to the storage of, and the provision of access to, information regarding the certified taxable person status of businesses can, by their nature, not be decided by individual Member States since businesses and tax administrations in all Member States should, in a standardised way, be able to check the certified taxable person status of businesses established in other Member States.

This requires a common framework and an initiative in this respect requires a proposal by the Commission to amend the VAT Administrative Cooperation Regulation.
The proposal simply defines a framework regarding the certified taxable person status, while operational control and application measures remain the responsibility of the Member States.

In particular, the granting or repealing of the certified taxable person status of individual taxable persons, based upon commonly agreed conditions, remains the sole competence of the Member States.

The aim is to provide the basis for the integration of the certified taxable person status into the VIES system (VAT Information Exchange System).

Currently, the VIES system is, inter alia, used to check the validity of the VAT number of a client in another Member State in order to ascertain that a supply of goods, transported or dispatched to that customer outside the Member State of supply, can be exempt from VAT.

From a practical point of view, the checking of the certified taxable person status of the customer in order not to charge VAT in case of an intra-Union supply of goods under the definitive system is quite similar as the checking of a VAT number.

Since the certified taxable person status is relevant in cross-border situations and since the IT infrastructure is already in place and used by all tax administrations, it is suitable to use the existing infrastructure and to extend its functioning in order to include the certified taxable person status of taxable persons.

To integrate the certified taxable person status, it is first necessary that Member States, who are in charge of granting and withdrawing the certified taxable person status of businesses that are established in their territory, collect this information and store it electronically.

To that end also information on the certified taxable person status of taxable persons is stored. It will be ensured that confirmation of the certified taxable person status of a particular person can be obtained by electronic means.

In the first step towards a definitive VAT system as proposed by the VAT Action Plan, in the case of intra-Union supplies of goods the reverse charge procedure should apply where the person acquiring the goods is a certified taxable person.
The new concept of the ‘Certified Taxable Person’ is thus particularly important during the transition period until the definitive system in 2022.

*It will allow CTP customers to continue purchasing goods free of VAT in other Member States and applying the reverse charge on these supplies.*

*For the Member States, the introduction of the CTP status will reduce the amounts of VAT channelling through the OSS (since liability will take place through reverse charge), while at the same time ensuring that the application of the reverse charge does not give rise to fraud, given that only reliable traders are allowed to apply the reverse charge.*

Starting 2019 according to this proposal taxpayers that have such status will therefore have a more beneficial position resulting in administrative and cash flow.

The Commission is also proposing today a number of short-term measures to improve the functioning of the VAT system until the definitive regime has been fully agreed and implemented.

These quick fixes address issues explicitly requested by both businesses and Member States, and cover:

- Simplification of VAT rules for companies in one Member State storing goods in another Member State to be sold directly to customers there. This simplification is limited to Certified Taxable Persons who will no longer need to register and pay VAT in another Member State when they store goods there

- Simplification for those elements of a chain transaction which do not involve the physical movement of goods, for example when goods are sold via several traders, but physically the goods move directly from the original seller to the final buyer. This simplification is limited to Certified Taxable Persons

- New harmonised and uniform rules so that traders can more easily provide proof that goods have been transported from one EU country to another. This simplification is limited to Certified Taxable Persons
• Clarification that, in addition to proof of transport, the VAT number of the commercial partners recorded in the electronic EU VAT-number verification system (VIES) is required for the cross-border VAT exemption to be applied under the current rules

How to become a certified person

Issues related to the storage of, and the provision of access to, information regarding the certified taxable person status of businesses can, by their nature, not be decided by individual Member States since businesses and tax administrations in all Member States should, in a standardised way, be able to check the certified taxable person status of businesses established in other Member States.

This requires a common framework and an initiative in this respect requires a proposal by the Commission to amend the VAT Administrative Cooperation Regulation.

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In particular, the granting or repealing of the certified taxable person status of individual taxable persons, based upon commonly agreed conditions, remains the sole competence of the Member States.

Taxable persons would be certified at their request by the Member State where they are established and this status would be recognised by all other Member States.

In order to obtain the status of CTP, a taxable person would need to meet a set of common, objective, harmonised at EU level, criteria.

Not all the categories of businesses would become eligible to apply for this status, but only those which meet certain criteria since the objective is to ensure that only reliable taxpayers are certified.
Further the certification would not be granted to non-taxable persons, flat-rate farmers, exempt SMEs, other exempt taxable persons without the right to deduct and occasional taxable persons since they do not have the obligation to declare VAT (or that obligation is purely occasional).

The criteria to grant the status would be similar to those used to certify traders for customs purposes (Authorized Economic Operator or AEO), i.e.:

- the absence of any infringement or repeated infringements of taxation rules and customs legislation, as well as of any record of serious criminal offences relating to the economic activity of the applicant;

- the demonstration by the applicant of a high level of control of his operations and of the flow of goods, either by means of a system managing commercial and, where appropriate, transport records, which allows appropriate tax controls, or by means of a reliable or certified internal audit trail;

- evidence of financial solvency of the applicant, which shall be deemed to be proven either where the applicant has good financial standing, which enables him to fulfil his commitments, with due regard to the characteristics of the type of business activity concerned, or through the production of guarantees provided by insurance or other financial institutions or by other economically reliable third parties.

Except for the categories specifically excluded, the certification would thus be open to all businesses.

The implementation of the criteria by the Member States would need to be proportionate so as to be capable of encompassing smaller businesses. Therefore, compliant businesses could apply for such certification and obtain it after due control by the national tax authorities.
Codified VAT Control Framework in EU

As Certified Taxable Person regime has to be codified in EU law, it is good from a benchmark perspective to have a look at a country that has already implemented this: Singapore and GST control framework. The building blocks of control framework are described below to benchmark 'current state' against.

Enhanced Taxpayer Relationship (ETR) Programme

The Enhanced Taxpayer Relationship (ETR) Programme was introduced in 2008 as a service initiative and aims to build an open and collaborative taxpayer relationship through regular engagement with large companies, mutually benefitting IRAS and these companies.

The ETR Programme is designed to address the needs of large companies and help these companies manage their tax compliance. It offers large companies the benefits of finalising their tax assessments in a timely manner through a collaborative review process with IRAS, as well as tax certainty on significant current events through consultation with IRAS.

At the same time, IRAS gains a better understanding of the company's business operations and with the knowledge, IRAS is better able to identify and address revenue risk early.

Scope of the ETR Programme

Through the ETR Programme, IRAS and the company's senior management (Chief Financial Officer or equivalent) will meet regularly to address the company’s current and emerging tax issues. The involvement of both IRAS' and the company’s senior management, as well as the commitment of resources from both parties, will facilitate timely resolution of the company’s tax matters.

Large companies with complex business models will benefit most from the ETR Programme as these companies are likely to have more complex tax issues. Currently, IRAS expects to have up to 200 companies on the ETR Programme.
Key Areas of Engagement

Under the ETR Programme, IRAS will engage the large company in one or more of the following key areas:

- **Specific issue resolution** - IRAS and the company will work on a mutually agreed plan to achieve timely resolution of specific tax issues.

- **Generic issue resolution** - Issues that are common to companies within a group are identified so that clear and consistent tax treatment can be applied on the same issue across the group.

- **Significant current events** - IRAS or the company may request early discussion and resolution of an upcoming significant event before filing of the income tax return so that downstream difficulties in assessments and objections can be reduced.

- **Review of tax control system** - IRAS and the company may work together to assess the adequacy of the company’s tax accounting and reporting controls, identify existing and potential gaps and discuss the remedial actions.

How to Participate in the ETR Programme

Companies that contribute a significant amount of tax revenue may be invited to participate in the ETR Programme. These companies are strongly encouraged to participate in the programme, especially if their corporate tax assessments are not up-to-date.

Companies that have not been selected by IRAS to participate in the ETR Programme but wish to do so may apply to IRAS in writing. IRAS will review the application on a case-by-case basis, based on the following criteria:

- Tax contribution from the company;

- Complexity of the company’s structure and operations;

- Current state of tax affairs of the company; and
• Company's willingness to commit resources to engage IRAS in the key areas, with the aim of bringing its tax affairs up-to-date.

**Assisted Compliance Assurance Programme (ACAP)**

GST ACAP is a compliance initiative for businesses that set up robust GST Control Framework as part of good corporate governance. Businesses may, on a voluntary basis, conduct a holistic risk-based review to endorse the effectiveness of their GST controls.

In the long run, a structure and a visible function properly set up to evaluate the impact of GST on the business transactions ensures the completeness and accuracy of GST reporting. In turn, a reduced risk of non-compliance with GST law ("GST risks") ultimately allows businesses to reap productivity gains - savings in both time and money.

**Businesses Suited for ACAP**

This programme is suited for businesses that:

• Have complex structures and business models;

• Engage in voluminous transactions;

• Place emphasis on tax risk management as part of their corporate governance; and

• Rely on extensive in-built controls in their systems and processes to generate timely and accurate data for financial and tax reporting.

Businesses that have established GST Control Framework at three critical levels (Entity Level, Transaction Level and GST Reporting Level) can undertake ACAP voluntarily.
Elements of GST Control Framework

Entity level
Senior Management - Incorporates GST risk management approach as part of the corporate governance. Senior Management and/or Boards of Directors- Maintains oversight of important GST matters. Control features pertaining to GST are established in:

- Control Environment
- Control Activities
- System Controls
- Change Management
- Information and Communication
- Monitoring and Review

Transactional level
Ensure the transactions are:

- properly tax classified
- accurately captured
- Essential preventive and detective controls are established for Sales and Purchases Cycles to manage GST risks.

Two main GST risks are:

- Compliance risk: risk that a transaction may not be correctly tax classified or comply with requirements under the GST law.
- Processing risk: risk that the processes in capturing the transaction may not be effective in generating accurate data
**GST Reporting level**

Ensure data extracted and compiled for reporting in GST returns are accurate and complete. Control features are established at:

- extraction of data
- compilation of data (including making adjustments to comply with GST reporting rules)
- filing of GST returns

**Qualifying for ACAP**

You are eligible for ACAP if you meet the following conditions:

- You have established acceptable GST Control Framework with key controls (listed in the 'Self-Review of GST Controls below') established at Entity, Transaction and GST Reporting levels.
- The auditor's opinion on your latest financial statements is unqualified.
- You are registered for GST for at least three years.
- You are currently not under any GST audit conducted by IRAS.
- You have good compliance records (including no tax outstanding with IRAS) for GST, Income Tax, Property Tax and with the Singapore Customs.
- You commit to engage a qualified ACAP Reviewer to conduct ACAP Review.
Relevant tax data from Transfer Pricing and VAT: explaining the ‘why’, ‘what’ and ‘how’

Tax moral is shifting. More often what is (still) legally allowed may not automatically be accepted by the public opinion. Reputational damage is imminent. Both on direct and indirect taxation the tax authorities have set their priorities. The tax authorities not only want to receive more tax data, but also faster and more often.

In addition, there is a tendency to allocate the ultimate tax responsibility at the highest level in a company. Since last year in the United Kingdom the Board of Directors has to sign off the company’s tax strategy and also publish the strategy externally.

Tax departments and the external auditors face due to these 2 tendencies new obligations. These tendencies could however also support change.

The new data requirements of the tax authorities have to be properly assessed and interpreted from a tax risk management perspective to see whether the data requested contain any unforeseen and major tax risks. The outcome of such an exercise could also make clear that the company has to reorganize its business and tax processes.

When all tax disciplines (e.g. TP, indirect tax; etc.) work together a joint responsibility for the overall tax affairs of a company could be established. That might facilitate the buy-in for tax investments. When successful tax can take the place it deserves: an important part of a company’s business strategy.

The auditor is not (yet) a risk analyst

The external auditor’s task is only to provide an opinion whether the annual accounts provide a true and fair representation of the company's affairs. He or she is not asked to

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1 Article is co-written with Edwin van Loon RTAP, Tax Control Framework Coordinator ING Bank NV
provide a statement regarding the accuracy or the acceptability of the submitted return for corporate tax, income tax, VAT, etc.

The term materiality has many meanings and definitions. Boundaries of materiality are primarily determined based on personal estimations. This can be estimations by auditors, risk management departments, company directors, etc.

The term materiality, used as a quantitative norm, then serves as an approval boundary. Evidently, the materiality used to determine the tax risk appetite of businesses is significantly lower than the materiality used by the external auditor in the annual audit.

The external auditor’s task is only to provide an opinion if the annual accounts provide a true and fair representation of the company’s affairs. He or she is not asked to provide a statement regarding the accuracy or the acceptability of the submitted return for corporate tax, income tax, VAT etc.

The examples of tax situations listed below should, however, also receive full attention from auditors. These stock market listed companies have after all, been obliged based on the SEC rules to report their risks to their investors:

- **Google** avoided €227 million in taxes in Italy. Google paid £130 million to the British tax authorities and agreed to pay higher taxes in the future. In France, the tax authorities demanded €1.6 billion from Google.

- **Apple** paid €318 million as a settlement to the Italian tax authorities after a two-year fraud investigation. Apple missed a deadline to pay €13 million in taxes to Irish authorities in the context of state aid. Due to the special treatment given by the Irish government, the effective tax rate was just 0.05%.

- **Facebook** (FB, Tech30) disclosed that the IRS conducted an investigation into the way it moved assets to an Irish subsidiary to avoid higher taxes. According to Facebook’s SEC filing, the amount totals $3 - $5 billion, plus interest.

- **Coca-Cola** was found to owe the US tax authorities $3.3 billion, plus interest, based on an audit by the IRS. Profits were incorrectly recognized in foreign countries, rather than the US.
In case these tax-related issues are considered individually per county and per company, it could be put into question whether these matters are also material for the auditor. Notably, the media also discuss the reputation of these companies.

Any potential reputational damage and/or fiscal uncertainty might impact not only the share price but also external relations including that with the tax authorities.

The loss of tax income due to the movement of assets to low tax rate jurisdictions is conservatively estimated to total between $100 and $240 billion.

The amount of media attention, public indignation and political reactions these cases have received – including for instance that of US senator and (former) presidential candidate Bernie Saunders – emphasize the differences in tax morality. Why should ordinary citizens comply with tax obligations, while multinationals or soccer players are attempting to avoid paying a ‘fair share’ of taxes by means of tax-saving structures?

Both media and politics have given a great deal of attention to cases such as the ‘Panama Papers’, ‘Lux Leaks’, ‘The Netherlands Tax Haven’ and ‘Football Leaks’.

In the context of an investigation regarding state aid, the European Commission states that providing tax rulings (advance pricing agreements; APA’s) should not result in situations in which some taxpayers pay less than other taxpayers under the same circumstances.

As a result of the Panama Papers, many Corporate Service Providers, shell corporations and advisors are interrogated by the Dutch parliament with regard to tax avoidance and tax evasion.

Due to the application of tax treaties, this construction results in a significantly lower corporate taxes. During his presidential campaign in 2008 Barack Obama illustrated the issue.

Richard H. Cornelisse
New legislation UK: Tone at the top

In an increasing number of countries, laws and regulations are established that force companies to be transparent with regard to their handling of tax risks, (fiscal) risk management, risk appetite – also in relation to tax planning – and the way of dealing with tax authorities.

This concerns the actual fiscal management, including the way in which the company makes tax decisions, for instance regarding distributed information about the systems and the means used for effective monitoring of fiscal risks.

The Finance Bill, that was established in 2016 by the United Kingdom, forces the Board of Directors of British multinationals not only to compose a tax strategy, but also to publish it. An important new aspect of this Finance Bill is that it obliges one person within the Board of Directors to be assigned the responsibility for the tax strategy.

*The power of this legislation resides in the fact that it forces the Board of Directors to actually determine a position regarding the company’s tax morality. This is recorded in a public statement, which makes it an important criterion in measurement and evaluation of the performance of the Board of Directors itself (fiscal KPI).*

Supervisory bodies such as the Supervisory Board (and auditors?) will have to evaluate whether the board indeed conforms to the formulated fiscal norm.

Moreover, as appears from the parliamentary history, it is expected that companies that have not published their business strategy are more likely to accept a higher risk appetite with regard to tax risks, compared to companies that have defined and formally published a strategy, both internally and externally.

There is a clear difference between this new legislation and existing initiatives such as the Senior Accounting Officer (SAO) regime in the UK. Whereas SAO is aimed at adequate tax accounting specifically, the new legislation goes beyond the SAO because it requires companies to provide insight into the business strategy with regard to taxes.
We think that this type of legislation realizes the objective measurability of the ‘Tone at the top’ in the fiscal domain. Without ownership and active involvement of the Board of Directors, the realization of vast changes or large investments is a hopeless mission when coming from change management.

*By placing the responsibility for the execution of the fiscal strategy on the Board of Directors, the tax division will receive the tools required for adequate execution of its function – mandate, resources, budget etc. – much faster.*

This will be amplified when signals from external sources – the auditor and the tax authorities – that promote prioritizing of taxes, also reach the Board of Directors.

The assignment of accountability, the composition and publication of the tax strategy would be an improvement of the current ‘Horizontal Monitoring’ policy in the Netherlands, as it brings the fiscal responsibility to the Board of Directors.

In practice, the Horizontal Monitoring relies too much on the relation between the Taxpayer coordinator (account manager) of the Dutch tax authorities and the Head of tax of the company.

**More attention for Transfer Pricing**

Many countries nowadays implement the BEPS recommendations such as the ‘master’ and ‘local’ file and the ‘Country-by-Country’ report. In general, this not only leads to an aggravation of Transfer Pricing (hereafter: TP) compliance activities, but also results in the potential discovery of errors that were previously undetectable. Indeed, TP processes are generally not (yet) automated and analysis activities regarding TP are primarily executed manually.

This situation makes it challenging to have all relevant tax data provided in time. This applies to both the collection of the required source data, as well as the TP analysis itself. Often, the supplied formats and templates are unusable or have to be ‘manually’ modified in Excel in order to be used.
The current trend is that increasingly more detailed information is necessary for specific products or services; ranging from who the order was placed by to details about the applied margins for service – and goods transactions and the conditions under which these took place. Timely access to such source data has thus become even more important.

This is also the ‘overlap’ with data required for the indirect tax function. Cross-border intercompany transactions form a risk area that will be included in the VAT risk matrix – risks that exceed the risk appetite – by every multinational and that requires efficient monitoring and checks.

More attention for VAT

The Big Four auditors emphasize in their Indirect Tax Surveys the increasing risks of reassessment, fines and reputational damage, as the importance of indirect tax amounts flowing through the accounts is increasing and the KPIs and effective monitoring is generally missing for indirect tax. Apparently, according to them, there is a long way to go before the resources, processes and technology-strategies are embedded and the responsibilities assigned to control the global VAT/GST challenges adequately.

Within Europe, extensive fraud in indirect tax is observed. The VAT-gap can be defined as the difference between the actually received and the theoretically calculated VAT-returns. The European Commission mentioned in September 2015 that the total VAT-gap amounts to €168 billion. The VAT-gap has been of this material magnitude for years. As a result, the prevention of VAT fraud naturally is high on the priority list of the European Commission.

From the action plan of the European Commission and ’20 measures to tackle the VAT gap’, we have selected a couple of actions that demonstrate the arrival of vast future changes. These will also influence the operation of the tax functions:

- Improvement of collaboration between EU and non-EU countries;
- Improvement of effectiveness of the tax services, including research into the possibility for automated data provision that enable the tax authorities to develop an automated mechanism to trace and connect individual transactions, in order to signal fraud at an early stage;
• Development of a new way of data collection by collaborating with the EU countries in
• Improvement of collaboration between authorities and a joint procedure for detecting and handling fraud.

**Tax authorities demand more, faster and more frequent data**

The fierce debate on a fair distribution of tax revenues by governments has reached new heights. Tax shift due to risk allocation of transactions to low tax rate countries and even globalization itself are under political discussion. Protectionism is an important part of the strategic objectives of certain governments.

Additionally, the discussion concerning BEPS and state aid have caused fiscal uncertainties that force companies to reevaluate risks. In some cases this can even lead to changes in the business model.

> Current business models are put under a magnifying glass, but also the change of business models – for instance from commissioneer to limited risk distributor – will get attention from the tax authorities.

A reorganization in the Dutch Tax and Customs Administration has established the objective that routinely and labor-intensive, yet relatively simple control activities are to be taken over by automated processes. That is, modern technologies appear to substitute to role of the ‘traditional’ tax auditor.

The idea is that new computer systems and data analysis software will allow data files from different source systems to be connected, thereby enabling more efficient tax control and requiring fewer ‘traditionally educated’ employees.

The objective also holds that the tax authorities have earlier and faster access to relevant tax data and that this data is periodically provided by tax payers in a format that is prescribed by the government and that can easily be read and immediately reveal inconsistencies in fiscal activities.
Transfer pricing and/or VAT regulations are still not sufficiently taken into account in the development of VAT-automation regarding business processes.

This makes that the data that is captured in a vast amount of financial administration, can ‘impossibly’ be compared with that which is stated on the tax returns.

SAF-T in an increasing number of countries

Other tax services are following the direction set out by the Dutch tax service. Often, the format developed by the OECD, the ‘Standard Audit File for Tax Purposes (SAF-T) is applied, in which specific ‘business accounting transactions’ from the ERP system are to be provided to the tax service in a prescribed format.

The SAF-T standard, originally created by the OECD, is intended to give tax authorities easy access to the relevant data in an easily readable format. This leads to much more efficient and effective tax inspections.

The legal requirements of the file are in line with the obligation of using certified billing and logistic software that prevent changes on documents already issued. The OECD has described which processes in an ERP system are required in order to be able to take a stance regarding the reliability of the electronic data that is used for substantiation of tax positions – corporate tax and VAT.
The guidance note describes the processes needed in business and accounting software to attain a sufficient level of reliability for electronic records kept in support of tax returns during the retention period prescribed by tax legislation in individual countries. The principles outlined cover:

1. Integration of effective tax protection controls;
2. Production of audit trails;
3. Enabling audit automation;
4. Production of SAF-T
5. Allowing users to file returns electronically;
6. Archive procedures to ensure integrity and readability; and
7. Provision of comprehensive documentation.

The following countries within Europe have implemented SAF-T: Portugal, France, Lithuania, Luxembourg, Norway, Poland and Austria

It should be noted though, that every country has its own local requirements and interpretation. Thus, there is no coordination or standard approach (yet). In practice, this results in potential differences per country that need to be managed individually from risk management by the tax function. Expansion of the SAF-T initiative to more countries is highly likely and therefore a further increase of e-audits (electronic data audits) is to be expected. Moreover, increasingly more data has to be provided.

*In most countries, the SAF-T data only has to be provided to the tax service in case an audit has been announced. Portugal, Poland and Lithuania however, also have an additional monthly SAF-T for VAT specifically.*

In this SAF-T the VAT data must be monthly provided to the tax service. The tax service can for instance compare the numbers with the filed VAT return. Usually, the ERP data is saved in an Excel sheet, which is subsequently used for making VAT corrections, but crucially without feedback to the ERP system.
When the Excel sheet forms the basis for the VAT return and the SAF-T solely uses the data from the ERP system, the numbers in the VAT return will not correspond with the VAT SAF-T. This can raise questions from the tax service and result in a higher chance of an audit.

*In many countries, tax returns are not immediately assessed. This could mean that in the most extreme scenario – in case there has been no audit – there will only be certainty when the period for recovery and reassessment has expired.*

This could all be different with e-audits, as these involve data with which the tax service can actually check the positions in the returns.

The implementation of SAF-T requires that data is only provided upon request from the tax service or afterwards in an extra monthly VAT requirement. This is an improvement compared to the traditional audit, which in practice, came down to an audit once every five years.

In China and Mexico, however, data is already provided to the tax service in ‘real time’. In these countries, VAT only becomes deductible when the customers can prove that they identified their suppliers by means of a VAT identification number and that the invoice is paid, mentioning the bank account number of the supplier to whom payments are transferred.

These measures appear to substantially reduce the opportunity for VAT fraud.
What about real time data provision in Europa? It appears be realized soon

- In Spain, a new VAT return systems has been introduced since July 1st, 2017. Companies are required to electronically submit all data of incoming and outgoing invoices in XML format to the Spanish tax service within 4 days after the invoice is distributed or booked. In the first 6 months, companies get 8 extra days as a transitional arrangement. So this is almost 'real time'.

- Hungary takes it one step further and requires companies to ask permission from the tax service in advance in the case of sales invoices over 100.00 HUF (€ 322). The invoice software of the taxpayer has a direct connection with the Hungarian tax service. This means that data must be submitted real time.

With these measures, a new trend has been set. The other European countries haven’t made that much progression yet, we do also know, however, that ‘best practices’ are exchanged in order to fight VAT fraud. Infosys has composed the overview that is displayed below. In Czech Republic, Hungary, Lithuania, Estonia, Italy, Romania and Slovakia, additional terms are already applied for VAT returns.

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2 Picture is developed by Krystian Stasiak, Infosys Centre of Excellence
The impact on in-house tax function

The topics that have been discussed in previous sections revolve around one central component: data. We mentioned investments by governments (and tax functions) in ‘data technologies and tools’.

In order to function optimally, it is essential that the tax function gains timely access to the relevant tax data. The benchmark studies form the Big4 show that investments are falling behind. The data is not only essential for tax returns but also for instance for analyses, pre-audits and tax planning.

A material tax risk arises when the tax terms under which a business model is supposed to operate are contradicted by its own financial and source data. For instance, the financial data might suddenly reveal new services, new goods transactions, different sales support, specific staff with a particular role and specialization.

A company is dynamic and the tax function should be timely involved in any changes. A tax control framework should thus take these changes into account and look beyond ‘compliance’ and financial risks.

Also consider the situation in which what is taken for a fact in a closed tax ruling, might then subsequently not correspond with the data that is (electronically) periodically provided to the tax authorities.

The same applies when the content of contracts does not correspond with the financial data. It thus also affects the control framework beyond taxes. The tax authorities receive increasingly more data over the years. The tax payer thus leaves a considerable audit trail.

One of the government’s objectives is to consociate cross-border individual transactions with each other, and to subsequently prevent VAT fraud. In case of a successful implementation, the scope and applicability might extend beyond solely VAT.
Tax authorities will demand increasingly earlier access to all relevant tax data, since this enables efficient, effective and (almost) real time audits. Real time data provision already prevails with respect to VAT. As previously mentioned, VAT and TP have considerable overlap with regard to relevant tax data. Developments and innovations regarding taxes therefore shouldn’t be analyzed separately for each tax discipline when it concerns for instance tax risk management.

*The starting point should be considering what data is to be provided to the tax authorities and which in-house tax discipline will be affected.*

**Preaudit before submit**

It is essential that the tax function does a risk analysis before the data is provided to the tax services. This sounds obvious, but doesn’t sufficiently happen in practice. Consider for instance compliance with SAF-T obligations.

The focus of Finance and IT is in practice on meeting the deadline of submitting the data as set by the tax authorities.

Often, the application of the ‘audit defense protocol’ is lacking, which would have been done in case of a traditional audit.

In this protocol, the occurrence of unanticipated risks is first internally assessed and evaluated, before submitting the requested documentation to the tax authorities.

Subsequently, a copy of the document is made and archived. Currently, this process is often omitted when data is submitted electronically, even though not only a data audit trail is left, but there are also multiple data requests which can eventually be analyzed in connection with each other. Consider for instance SAF-T and all BEPS requirements.

The innovations and changes also demonstrate that solely technical knowledge is no longer sufficient. Developments should be anticipated early and current limitations must be translated into solutions.
This requires knowledge of change management, but also of technology and audit software and/or data analysis skills. A background in accounting seems more important than ever considering the innovations as well as the data requests from the tax authorities.

**Possible analysis questions**

<table>
<thead>
<tr>
<th>Nr.</th>
<th>Question</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>All documents, audit files for tax purposes are easily accessible.</td>
<td>N/A</td>
<td>Weak</td>
<td>Needs strength</td>
<td>Average</td>
</tr>
<tr>
<td>2</td>
<td>Tax department utilizes leading edge tools and technologies in an integrated manner fully leveraging the functionality offered.</td>
<td>N/A</td>
<td>Weak</td>
<td>Needs strength</td>
<td>Average</td>
</tr>
<tr>
<td>3</td>
<td>All relevant tax data can be accessed in a timely manner, relevant information or data is received timely.</td>
<td>N/A</td>
<td>Weak</td>
<td>Needs strength</td>
<td>Average</td>
</tr>
<tr>
<td>4</td>
<td>The majority of tax data is collected once and reused by departments.</td>
<td>N/A</td>
<td>Weak</td>
<td>Needs strength</td>
<td>Average</td>
</tr>
<tr>
<td>5</td>
<td>ERP and other systems are tax enabled and support compliance, financial reporting and tax planning.</td>
<td>N/A</td>
<td>Weak</td>
<td>Needs strength</td>
<td>Average</td>
</tr>
<tr>
<td>6</td>
<td>There is dedicated IT support for tax.</td>
<td>N/A</td>
<td>Essential</td>
<td>Nice to have</td>
<td>Irrelevant</td>
</tr>
<tr>
<td>7</td>
<td>Spreadsheets are replaced by technology tools and systems to make information more efficient available.</td>
<td>N/A</td>
<td>Essential</td>
<td>Nice to have</td>
<td>Irrelevant</td>
</tr>
<tr>
<td>8</td>
<td>Contribute and exchange knowledge is technology enabled</td>
<td>N/A</td>
<td>Weak</td>
<td>Needs strength</td>
<td>Average</td>
</tr>
<tr>
<td>9</td>
<td>Critical tax information is generated frequently throughout the year to influence prospective business, tax decisions or reduce tax audits</td>
<td>N/A</td>
<td>Weak</td>
<td>Needs strength</td>
<td>Average</td>
</tr>
<tr>
<td>10</td>
<td>The operating efficiency could be significantly improved if investments in technology are made</td>
<td>N/A</td>
<td>Essential</td>
<td>Nice to have</td>
<td>Irrelevant</td>
</tr>
<tr>
<td>11</td>
<td>Improvement points are identified and action are taken for implementation.</td>
<td>N/A</td>
<td>Weak</td>
<td>Needs strength</td>
<td>Average</td>
</tr>
</tbody>
</table>
Concluding remarks: towards a shared responsibility

One of the questions refers to the reuse of data. In the paragraph TP, we described that in the future, increasingly more detailed information on individual transactions is required for analysis and planning.

Cross-border intercompany transactions appertain to the risk area of both TP and VAT. Applying the same source of information is thus not only efficient and effective but can also serve as an argument for substantiating new ‘shared’ investments towards senior management.

We also described that with respect to VAT, in spite of risks, there is a long way to go before the means, processes and technology strategies will be imbedded and the responsibilities are determined to adequately manage global VAT/GST challenges.

The fact is that both TP and VAT are lagging behind, yet are in the full spotlight of the tax authorities and often either have no budget for investments or lack manpower (size of the tax function) and internal skills (factor knowledge).

The outlined tax risks and the importance of managing the reputational risks not only affects the tax control framework, but also the overarching business control framework and this automatically implies a higher priority and required involvement of the Board of Directors.
The fact that in the UK, the Board of Directors already has final responsibility and the tax strategy must be published publicly, can substantiate the internal sale of new investments from business plan perspective and realize more shared responsibility.

When everything is regarded as interconnected, acknowledging that also best practices are shared between governments, the chances of this final responsibility also being extended to other countries are highly likely.

It is indeed a joint objective of the EU members to exchange new ways of data collection, including 'best practices' regarding new 'reporting' and 'auditing' applications.

The external accountant and tax service can express this same message from outside to the Board of Directors in order to contribute to the development, which will in turn be of importance for their own (future) functioning.
Tax Risk Management - submitting tax relevant data to the tax authorities

A sound tax audit defense

Tax authorities are besides optimizing traditional tax reporting systems increasingly implementing in addition electronic (almost) 'real-time' transaction reporting systems.

It is expected that tax authorities due to technological innovations become increasingly better and faster in executing their tax audit.

Complementary to the existing and more traditional tax reporting in countries like Austria, France, Lithuania, Luxembourg, Portugal, Spain already (close) to real time data request have to be submitted and/or should be available on short notice when a tax audit is announced.

What is next on the agenda?

- **Italy** - the VAT invoices data informative reports must be filed with the tax authorities on a six-monthly basis starting by September 28, 2017 for invoices issued and purchases registered during the first half year 2017. From 2018 the deadlines will be on a quarterly basis.

- **Hungary** - real time invoicing is postponed to 1 July 2018. Companies need to have a solution implemented that is capable of real time data transfer by 1st of July 2018 at the latest.
• **Norway** - Norway has postponed the implementation of Standard Audit File for Tax reporting (SAF-T) requirements. It will now become mandatory in 2018 in stead of 1 January 2017.

• **Poland** - Filing SAF-T became mandatory for large taxpayers that employed more than 250 people or 50 million EUR sales revenue irrespective of whether they are established in Poland or not in 2016. Per 1st July 2018 this is extended to taxpayers with more than 9 employees or 2 million EUR sales revenue.

**Aim: faster and better tax audits**

It is however not clear how the tax authorities actually will analyse the data received. That might change soon as their strategy is to improve tax audits and combat VAT fraud.

Most realistic is that specific data analysis software will be developed or is already in development. Such data analysis can also show how transactions are processed and how IT systems are set up for VAT.

> Data integrity is therefore becoming a greater risk factor when transactions are booked in any given country and are not properly evaluated for tax purposes.

> It could be that the financial data in the system does not reflect the business model design, that any change of the business has not been properly managed or the submitted data contains VAT errors with a root cause incorrect VAT SAP configuration.

From a VAT perspective the tax authorities will most likely check the submitted data with the filed and signed VAT reporting. Does it actually reconcile?

VAT reporting and these data requests have both the same source and that is SAP itself. When the VAT treatment is not properly configured in SAP such data analysis will detect VAT errors.

The submitted data that the taxpayer leaves behind at the tax authorities - sometimes for many years - will be used not only for as said faster and better tax audits but also to argue the amount penalties to be imposed.

*Richard H. Cornelisse*
Penalties might increase when it becomes clear from that data that tax risks were more or less accepted for many years as an effective tax control framework was apparently not operational.

**Risk Management: how can you defend yourself?**

A VAT configuration review can be used as a counter measurement as part of sound tax audit defense. The outcome of such a configuration review should show where VAT errors in SAP occur. The deliverable has to provide a clear understanding of how changes in the business model, master data or legislation had an impact on the SAP VAT configuration at hand. When starting such an exercise the objective is to understand first the operational business model and the current SAP VAT set-up.

Best practice is to start therefore with an interview to get a good grip of that model and subsequently download based on our instructions the SAP VAT configuration and condition tables. More efficient might be to grant remote access to SAP to download these tables directly. The deliverable should provide an overview of:

1. Material VAT risks and SAP VAT weaknesses
2. Quick wins to resolve, and
3. Any remaining VAT issues how to remediate in the mid or long term

**Examples of SAP VAT errors**

- Ineffective design of VAT condition tables. This can result in “non-maintainable” condition tables and/or incorrect VAT results
- Ineffective use of available VAT sensitive data in orders. This can result in the standard VAT calculation generating incorrect results
- Incorrect derivation of VAT registration numbers for cross-border transactions caused by incorrect SAP configuration
- Not applying local reverse charge for foreign registered companies in some EU countries
• Incorrect configuration of the tax codes and sub-optimal use of standard SAP functionality and reporting options

• Blocked iDocs (electronic interface documents) because of errors in the OBCD design

**VAT fraud - an effective control framework**

Companies should create awareness and setup customized counterparty acceptance measures as well as using detection and prevention tools, preferably as part of an overall tax risk management approach:

• Setup of specific counterparty acceptance policies aimed at tackling potentially risky clients with respect to VAT fraud

• Review the current counterparty population and conduct a risk assessment of AP and AR invoices for possible joint liability or possible denial of deduction of input VAT due to a fraudulent counterparty. The test is: ‘did the taxable person, when he entered into the transaction, know or should he have known that it was ‘connected with fraudulent evasion of VAT’?

   *The challenge is to cause as little disruption to daily business as possible and to embed reasonable and practical measures.*

**Missing Trader Intra-Community VAT fraud**

VAT fraud covers a wide array of different types of fraud using both goods and services, including:

• Unregistered taxable persons

• False invoicing;

• Missing Trader Intra-Community (MTIC) fraud; and

• Smuggled goods (fail to pay import VAT and duties).
‘Missing trader’ fraud involves obtaining a VAT registration number in a Member State for the purpose of purchasing goods free of VAT in another EU Member State. These goods are then sold in a Member State at a VAT-inclusive price. After which, the trader will go missing or default, without paying the VAT due to the tax authorities.

‘Carousel fraud’ (MTIC fraud) involves trading the same goods around supply chains within and beyond the EU. The goods will re-enter a Member State on a number of occasions with the aim of creating large unpaid VAT liabilities and fraudulent VAT repayment claims.

Businesses operating in high risk industries such as mobile telephones, microchips or other, easily transportable and high value goods, must pay particular attention to their supply chains.

These companies are at higher risks.
VAT Control Framework: how to get from A to B

The critical conditions for success

The importance of indirect tax has increased over the last couple of years. While the rates for direct tax, corporate income tax, are decreasing, the rates for indirect tax keep rising. At multinational companies we’re easily talking about amounts of over 5 billion euros of indirect tax flowing through the books.

According to big4 surveys, the related control mechanisms are still inadequate. Not only can an error in the accounts lead to major additional tax assessments and substantial penalties, with amounts like these, it can be devastating for the reputation of a listed company.

We are talking about extremely large amounts of money that lack appropriate control, but because KPIs have never been developed for this particular purpose, the risks remain outside the CFO’s field of view.

The Indirect Tax Function is aware of the fact that it is understaffed and that budget is too limited to optimally execute its tasks, but they often don’t know how to change this and get it on the agenda of the CFO.

It’s essential that change comes from the organization itself. An advisor can repeat this over and over, but if it isn’t carried out within the organization, by the people who actually have to work with it, nothing will change. And that deadlock must be broken.

What should be done to actually break it?

I will explain
Adequate control mechanisms

A VAT Control Framework - when addressing proper risk management - should be in line with Business Control Framework and a company's overall Tax Control Framework.

From a governance perspective the indirect tax department has to be positioned and should be given the tools - e.g., budget and resources - to realise its strategic objectives as highlighted below in a table.

<table>
<thead>
<tr>
<th>Tax Governance</th>
<th>Activities</th>
<th>Strategic objectives per role</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Business Control Framework and overall Tax Strategy is translated to a VAT Control Framework</td>
<td>Agree with senior management the risk appetite for VAT (materiality for Tax Control Framework and KPI) controls</td>
<td>Senior management has signed off a tax policy that describes what is considered a not acceptable risk and when Indirect Tax Department should be mandatory involved. Tax policy is communicated to relevant stakeholders and whether or not the instructions are met is monitored</td>
<td></td>
</tr>
<tr>
<td>The VAT Policy derived is signed off by senior management and departments are instructed when Indirect Tax Department should mandatorily be involved upfront or when the indirect tax department should be in the lead for managing change</td>
<td>To ensure that what is agreed with senior management is known as a responsibility and followed up by stakeholders/process owners</td>
<td>The indirect tax department objectives and strategies are clearly aligned with the company's business objectives and strategy as a whole. Updates are considered periodically</td>
<td></td>
</tr>
<tr>
<td>The objectives set by the Indirect Tax function are signed off and the means to execute are provided by senior management</td>
<td>Indirect Tax Department professionals are appointed to support multidisciplinary teams in projects and programmes</td>
<td>To set clear, accessible and workable instructions, policies, standards, manuals and guidelines endorsing KPI's culture</td>
<td></td>
</tr>
<tr>
<td>All departments and key process owners are well informed and/or have the availability of a VAT work instruction so it is clear when to consult the Indirect tax department</td>
<td>To ensure that VAT control framework is aligned with business control framework and tax strategy and does not operate in silos</td>
<td>Policies, procedures, working instructions and manuals are available on line to all (relevant) employees</td>
<td></td>
</tr>
<tr>
<td>Communicate lines are setup to report periodically whether VAT risk identified are exceeding KPI's risk appetite</td>
<td>To ensure that everybody's roles and responsibilities are known</td>
<td>To ensure that KPI act consistently and benefit from best practices</td>
<td></td>
</tr>
</tbody>
</table>

**Richard H. Cornelisse**

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*Filling of all required indirect tax reporting, including preparation of proper support files:*
- Reduce unreported risks
- Avoiding penalties for late filing
- Review indirect tax assessments:
  - Development and maintenance of a VAT risk register
  - Ascertain that appropriate action is taken before the deadline passes
  - Apply proper cash management
  - Ensure that resources and budget is aligned with the outcome of the Risk Assessment (we spent most of our time on high risk areas)

**Tax audits:**
- Optimize the tax audit process and outcome
- Limit the duration of tax audits
- Assist and support other departments:
  - Indirect Tax Department is up to date with latest developments and has an advisory role to the business
  - Indirect Tax Department is recognized as an important value adding (business) partner of the business line / organisation
  - Ensure that KPI benefits from the skills and expertise of the Indirect tax function
  - Ensure that the value of indirect tax Department is clear for the business
Define indirect tax objectives.

That the indirect tax objectives should create, protect and optimize value in the range of company’s business objectives is an obvious one.

Some other objectives that could be considered:

- The tax function should ascertain proper implementation and determine the impact of changes in businesses, laws and regulations on implemented tax planning.
- VAT should be considered in every aspect of the process, from concept through completion and beyond.
- Technology-related tax risk: understand and address the potential harms and benefits of (new) technology.
- Commit to pay tax in accordance with all relevant laws and regulations in the territories of operation.
  - The objective of the indirect tax department is to minimize unnecessary cash out flow of output VAT and the complete deduction and reclaim of input VAT where possible.
  - When executing this objective the cash flow position must be taken into account and no additional risk on VAT audits must be created that exceeds company’s risk appetite.
- Sustain a good and honest working relationships with the tax authorities seems a logical one.

Who is accountable and what is the added value of a tax policy

Accountability should always be set at the level of a process owner end responsible for a specific business process and the tax policy published should realise proper awareness with respect to tax risks and make clear to that process owner 'who can decide what and when' from a tax perspective.

It should therefore be the responsibility of the head of each corporate department to ensure all team members read, understand and effectively implement that tax policy.
An indirect tax department will face challenges when no formal documented tax policy, tax objectives or tax planning exists as an overall tax instruction will be lacking about the ‘do’s en don’ts’ within the company.

It is critical that senior management signs off and publishes agreed-upon objectives and risk tolerance levels for tax planning and tax risk management: ‘the tax rules of the house’.

In practice the starting point for realizing tax function effectiveness is often beginning to draft such ‘a tax policy’ where those ‘tax rules of the house’ are set, decisions are made to introduce new tax rules and the execution of these rules are considered realistic objectives and that compliance to these rules is regularly assessed and performance is measured.

Without a tax policy it depends on VAT employee’s personal influence within the company to kick-start change. Often that results in a fragmented approach as not all stakeholders within the company will be convinced that amendment is needed.

The outcome is that this will negatively impact the existence of standardised VAT controls or the effective implementation of ‘best practice’ approaches. More important the company becomes dependent on people and the amount of risks will increase when that skill-set leaves the company or gets internally an other function.

That will be avoided and improved when the tax department’s strategy, objectives and risk tolerance is understood by everybody in the tax function and throughout the organisation and mandatory in force as a rule within the company.

A tax policy steers than the behaviour of all employees aimed at achieving the overall tax function objectives. This is shown in Existence and Operation below:

- Governance - How do we decide to introduce new rules
- Design - How do we determine the rules we need
- **Existence - How do we ensure the rules are embedded**
- Operation - How do we establish that our rules are executed
Employees are under these circumstances end responsible and have an obligation to meet these in-house tax rules. The tax department, internal audit department or risk management can much easier assess whether or not tax rules are properly executed or not and a key periodical business control question has only to be raised: ‘have you worked according to the tax policy’.

It is not just a paper trail like we normally see in practice during Sox controls with respect to tax.

That is because tax policies (overall tax and VAT) are in place and someone is actually made end responsible. That can make it much easier to remediate when VAT risks come up via preventive or detective test of tax controls. The indirect tax department should get immediate commitment when a process owner has apparently failed in that obligation. It also would be mandatory to provide support to the tax department to close that gap together as soon as possible.

**Why?**

*It should be much easier to realize as only a reference has to be made to the company's own in-house tax rules and the expected tax behavior by senior management. When successful it will be the new and enhanced 'in-house tax culture'.*
Design and roll out of a tax policy

Such a tax policy should define the company's overall tax strategy and tax objectives and establish a framework to promote best practices and governance procedures. The policy should outline the roles and responsibilities of the tax function, other corporate departments, and corporate entities.

The tax policy written should be rolled out to entire tax and the wider business to ensure a shared understanding of company's VAT risk appetite and acceptable VAT planning. The roll-out may include workshops and conference calls with tax, finance, legal, the business, etc.

Unlike the more contained structure for handling income-based taxes, responsibilities and key drivers for indirect taxes may be spread throughout the enterprise, residing not just in the tax department but in any of such diverse departments as finance, information technology, supply chain management and logistics, human resources, and beyond.

*The tax policy is the highest in tax hierarchy - signed off by senior management - and sets the internal tax rules and tax behaviour: the do's-and-don'ts of employees with respect to tax.*

Building blocks of a tax policy

The following taxes fall normally under the scope of such a tax policy - all taxes the Head of Tax is end responsible for:

- Corporate income tax
- Wage taxes, payroll, and social security
- Withholding taxes
- Capital taxes (including stamp duties and transfer taxes);
- Local taxes (e.g local business tax, packaging tax, sur tax, gift tax)
- Indirect tax and customs duties
- Etc.
Some key building blocks of a tax policy:

- Tax function objectives
- Risk profile and VAT risk tolerance parameters
- Approach to tax risk
- Relationship with tax authorities
- Scope of taxes covered
- Entities in scope
- Roles and responsibilities
- Tax resources (internal / external)
- The tax strategy detailed per role and / or applicable tax
- Situations when mandatory upfront involvement should take place

It should include detailed guidelines around the type of VAT planning and whether this is allowed according the company’s tax policy. These guidelines should be approved by senior management and may include issues such as the likelihood of tax administration to challenge and litigate the potential change to the group’s VAT risk profile and key reputational risk issues.

This may also cover documented planning evaluation and acceptance criteria, planning implementation review processes and an ongoing planning review and monitoring processes.

**Mandatory involvement upfront**

*From a Tax Control Framework perspective, for setting up risk based controls, the more unusual the transactions, the greater the tax risks.*

The tax policy should contain as well a description of situations when it will be mandatory to involve indirect tax department upfront (e.g., stakeholders such as Legal, IT, HR, Internal Audit, Procurement, Business, Finance).
The following transactions will always exceed a company's VAT risk appetite:

- Significant business transactions
- Non routine transactions:
  - Share issues or sales
  - **Reorganisations**
  - **Acquisition or disposal of any business or part of a business**
  - Acquisition or disposal of real estate
  - **Financial transformation**
  - **Part of the business is outsourced** (e.g. a Shared Service Centre or accounts payable/receivable to a third party service provider)
  - Other financial transactions

Recommended is to describe in detail the requirements for other process owner/stakeholders to seek VAT input early in the process. It should cover non-routine or significant business transactions and the requirement for review & approval by indirect tax department prior to execution of the transactions. The indirect tax department should always be a mandatory work-streams in for example technology and finance projects.

Operational changes have a tax consequence due to the change in transactional flows and the change in a company’s assets, functions and risks profile. Important is to ensure that the new operating model is not only implemented correctly from a direct tax perspective, but also ensures that business processes are overall tax aligned realising support of the business in the areas of compliance, finance & accounting, legal, IT systems, VAT and regulatory matters.

*To move the tax policy from paper into practice the roll-out may also include organisational changes, and improvements to processes and systems.*

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3 See chapters: M&A integration: managing the moving parts before, during, and after a transaction, The Intersection of VAT and shared service centers, and Change of a company’s business model

*Richard H. Cornelisse*
Efficient and effective use of VAT resources

As VAT resources are normally scarce within a company it is important that their available time is used in the most efficient and effective way.

It is about making the right choices and that resources and budget needed is in line with the outcome of the tax risk assessment.

Due to limited VAT resources available time should be spent first on high-risk areas. In order to allocate resources to risk and cost saving areas that matter, the level of risk appetite of the company has to be determined. This facilitates prioritisation in the deployment of resources. Having defined acceptable levels of risk leads to resources not having to spend time on further reducing risks that are already at an acceptable level.

The efficiency and effectiveness of indirect tax department should be periodically measured and compared with financial and operational KPIs. This should subsequently be discussed in review meetings and corrective actions have to be identified and executed.
Benchmarking Risks and Controls

When a tax policy is not yet written, a first action item could be for designing such a tax policy to agree with senior management the company’s overall VAT risk tolerance parameters and benchmarked that against a normative VAT Industry Risk and Control Matrix and determine the ‘impact and likelihood’. To manage mutual expectations the opening question could be:

*What do you consider still an acceptable outcome in numbers from a worse case perspective when the tax authorities have performed a VAT audit and raised an assessment.*

**Risks: 'impact' and 'likelihood'**
Normative "VAT Risks", "Controls" and "Test of Controls" are provided in next chapters:

- Tax Governance
- Strategy
- Risk Management and Cash Flow optimization
- People
- Change Management

Above critical building blocks are most of the time not yet included in a Tax Control Framework.

Benchmarking results therefore in better visibility and awareness of the current state and can quickly assess where (further) improvements can be made.

Those normatives can be used not only for such a GAP analysis but as well from a design as a first starting point to set clear tax objectives.
Tax Governance

Key element is to agree who can decide what and when, establish the right level of control, inform responsible employees and conclude and report the level of ‘in control’:

- Analyse and evaluate weaknesses
- Review status of remediation
- Consider changes in control environment
- Draw conclusion about the level of ‘in control’

Who can decide what and when' relates to the tax function objectives, the processes in scope and the required levels of control and inform those responsible for achieving these objectives, the process owners, about the tax policies signed off by senior management:

<table>
<thead>
<tr>
<th>Governance</th>
<th>Process</th>
<th>Normative VAT Risk</th>
<th>Normative Control Activity</th>
<th>Normative Test of control</th>
</tr>
</thead>
<tbody>
<tr>
<td>An adequate governance structure has been set up</td>
<td>Risk and control culture will not embed in the organisation - TCF becomes a checklist - TCF remains a ‘project’</td>
<td>The following has been taken into account: Responsibilities have been clearly assigned: VAT policy signed off by senior management; Instruction with sponsorship of senior management is published to process owners when Indirect Tax Department is mandatory involved upfront; Tasks have been clearly assigned; Risk appetite and risk tolerances have been defined; Prioritization of issues and escalation steps have been defined; Risk Response have been defined (Transfer, Treat, Terminate, Take); Risk management committee has been defined; Monitoring functions have been defined</td>
<td>Verify existence and quality of the sign off</td>
<td></td>
</tr>
</tbody>
</table>

- Assign tasks and responsibilities
- Set procedures for implementing (new) rules
- Set risk appetite, risk tolerances and cost-benefit guidance
- Prioritize and escalate
- Desired versus required level of formalization
- Determine and report on the actual level of ‘in control’
A relevant VAT strategy—correctly implemented—will allow the business to function effectively from any go-live, from both a tax and commercial perspective, so that it can generate sales and invoices, face fewer disputes with non-paying customers, remain tax compliant, and integrate the business on time and on budget.

Normative Risks, Controls and Test of Controls have been defined to benchmark against.
Risk Management and Cash Flow Optimization

Tax risk management strategy should differentiate in strategic, reputational, operational, and financial and compliance risks and contains detailed action plans for managing these risks.

Sox and similar business control framework initiatives are focussing currently primarily on financial and compliance risks. Those risks relate directly to the reliability of the annual report resulting that a much higher ‘acceptable’ materiality threshold is used.

The consequence is that many VAT risks that matter from a VAT Control Framework perspective will most likely not be scoped in.

Besides risks and cash savings the reward could also improve operationally efficiency. The hidden factory is defined as the amount of rework and cover ups, the hours and days of wasted time in a company of people who constantly correct mistakes. Savings but also more effectiveness from a tax control framework can be realized when that rework would be avoided.

The objective is to make the hidden factory visible (measure/calculate ROI) and as a result return precious time and money back to the business.

Example: how much rework is required before numbers received from finance systems can be used?

VAT risk categories

- Financial and compliance
- Strategic
- Operational
- Reputational
# Normative VAT Risk Management

## VAT Risk Management

<table>
<thead>
<tr>
<th>Risk Identification</th>
<th>Process</th>
<th>Normative VAT Risk</th>
<th>Normative Control Activity</th>
<th>Normative Test of control</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk assessment is performed</td>
<td>Organisation's objectives and financial KPI's might not be met if VAT risks are not properly managed</td>
<td>A strategic business resource is appointed for the maintenance of a comprehensive VAT Control Framework and mitigating areas of VAT exposures and to ongoing maintain its master a tax control framework: Ensuring that unacceptable indirect tax risks will be prevented Ensuring that unacceptable indirect tax risks will be identified Ensuring that identified indirect tax risks will be managed and mitigated A VAT throughput analysis is performed Overview of changes in business that might impact VAT-processes is available and assessed regularly An objective method is used to measure risk; e.g. sampling, statistical sampling, data analytics, system review A risk register is setup and monitored (versions are signed off) Risk in risk register are evaluated again when volume of transaction changes and/or due to new case law Root cause analysis is performed</td>
<td>Verify analyses are performed on a periodic basis and analyses of potential anomalies are performed Verify a process is in place to ensure changes that might impact VAT are timely identified and the existence of a risk register Review that the risk register is updated: check that version are signed off and review changes Assess the techniques used to identify risks - subjectively and objectively Verify whether root cause analysis is performed and actions are taken to avoid future risks</td>
<td></td>
</tr>
<tr>
<td>Risk profile is documented</td>
<td>Organisation's objectives and financial KPI's might not be met if VAT risks are not properly managed</td>
<td>Based on KPN's Tax Policy, a risk profile is documented and assessed periodically</td>
<td>Verify that a risk profile has been documented and is based on the Tax Policy Verify a procedure is in place to assess the risk profile on a periodic basis</td>
<td></td>
</tr>
</tbody>
</table>

## Planning of non-routine transactions and substantial business transactions

| Process | Organisation's objectives and financial KPI's might not be met if these material VAT risks are not properly managed | There is a process that ensures indirect tax is involved in any non-routine transactions to assess impact. Examples are: Migration to new jurisdictions Business model change Use of Shared Services Centers / Outsourcing M&A activity Substantial business transactions | Verify that a risk profile has been documented and is based on KPN's Tax policy. Verify a procedure is in place to assess the risk profile on a periodic basis |
Normative Cash Flow Optimization

<table>
<thead>
<tr>
<th>Cashflow optimisation</th>
<th>Normative VAT Risk</th>
<th>Normative Control Activity</th>
<th>Normative Test of control</th>
</tr>
</thead>
<tbody>
<tr>
<td>Focus on achieving working capital and cash flow improvements</td>
<td>Financial KPIs will not be met if VAT cashflow risk are not properly managed</td>
<td>There is a process based on data analysis to identify cashflow opportunities: Accounts Payable: Late purchase invoice posting Import from outside the EU Self billing opportunities have been investigated Accounts Receivable: Elimination of Output VAT has been assessed and implemented to the extent possible</td>
<td>Verify there is a process in place to ensure the Financial KPIs are known from a VAT perspective and monitoring takes place to ensure the Financial KPIs are not negatively impacted from a VAT perspective</td>
</tr>
</tbody>
</table>

Monitoring

| Monitoring of risks and controls is performed | Financial KPIs will not be met if VAT cashflow risk are not properly managed | Controls are monitored for effectiveness: Part of Internal Audit plan Remediation plans are being developed for identified issues. Root cause analysis is performed to define steps to prevent issues from reoccurring. Monitoring (line and Internal Audit) role takes assessment of Tax authorities into account. | Verify there is a process in place to ensure the Financial KPIs are known from a VAT perspective and monitoring takes place to ensure the Financial KPIs are not negatively impacted from a VAT perspective |

People of the VAT function

The tax department needs to consist of the right number of tax personnel and the right level of skills and capabilities to execute all its tax objectives.

The indirect tax function is aware of the fact that it is understaffed and that budget is too limited to execute its current tasks.
It follows also from Big4 benchmark studies as referred to below. The weakspot is that knowledge is lacking how to change this and get it on the agenda of the CFO. The deployment of expensive fiscal knowledge nowadays often usually remains limited to control of direct tax.

'As is' exercise: currently, the Indirect Tax Department employs X amount FTE; X amount Indirect Tax advice and X amount FTE VAT Compliance.

The overall VAT ‘community’ is larger. For example employees that work part-time on VAT matters, but are formally not in the tax function but have a role in managing certain tax affairs (e.g make VAT decisions (AP/AR), provide critical information, supportive to VAT reporting, etc.). They are the 'shadow tax function'.

Assigning new responsibilities or extra tasks to the indirect tax department or 'shadow tax function' due to the new 'tax policy' in place will have impact on current VAT workload.
That means new priorities have to be set - focus only on key issues - and when still an overload of work exists, work should be delegated to extra resources either internal or external.

*Providing resources, budget and/or innovative tooling is important when a company wants to realise change. Without senior management buy-in that will often be a mission impossible.*

**Change Management**

The focus is often in a VAT Control Framework on managing inherent risks and less on avoiding future risks. The root cause is that the primarily focus is often still on - due to the company's business control framework - whether correct and in time VAT reporting has been filed. That is a look back exercise and only financial and compliance risks are often considered.

Avoiding future risks is important from a VAT Control Framework perspective as it reduces future firefighting (e.g. rework) and any unforeseen exposures.

The following items the normative risk and control framework are presented from a change management perspective for internal benchmark purposes:

- VAT Policy
- Change in VAT legislation
- Changes in the business
- Advice to the business and other reporting requirements
- Changes in the business and maintaining relationship with tax authority
- Configuration of accounting systems
- Changes to VAT rates and VAT condition tables or logic
- VAT element of material master data
# VAT Policy

## Benchmark against 'as is'

<table>
<thead>
<tr>
<th>VAT Policy</th>
<th>Normative VAT Risk</th>
<th>Normative Control Activity</th>
<th>Normative Test of control</th>
</tr>
</thead>
<tbody>
<tr>
<td>Policies and procedures around VAT are documented in a VAT Policy</td>
<td>Unclear responsibilities and tasks not performed timely and adequately</td>
<td>The following has been taken into account: VAT Policy signed off by senior management; Responsibilities for existence and maintenance of VAT Policy have been assigned; The indirect Tax function updates the VAT Policy detailing the relevant VAT processes, procedures and work instructions for: - Administration, AR, AR Sales, purchasing department - Legal - AM; etc.; Instruction with sponsorship of senior management is published to process owners when VAT TDC is mandatory involved upfront; Tasks have been clearly assigned; Risk appetite and risk tolerances have been defined; Prioritisation of issues and escalation steps have been defined; Risk Responses have been defined; Transfers, Treat, Terminate Table; Risk management committee has been defined; Monitoring functions have been defined.</td>
<td>Verify the VAT manual exists and ownership for maintenance has been assigned.</td>
</tr>
<tr>
<td>VAT Policy is updated when needed</td>
<td>Unclear responsibilities and tasks not performed timely and adequately</td>
<td>There is a process in place to update the VAT manual based on: - Update of VAT strategy - Changes in law and regulations (VAT fraud measurements) - Changes in risk profile - Exceptions noted.</td>
<td>Verify there is process for updating. Check last update date.</td>
</tr>
<tr>
<td>VAT Policy is communicated in the organisation</td>
<td>Unclear responsibilities and tasks not performed timely and adequately</td>
<td>After updates the VAT Policy is reviewed and approved by Tax Director, Director Accounting &amp; Reporting and the CFO and distributed to departments. Use of newsletters to communicate recent changes.</td>
<td>Verify there is process for communicating updates to the VAT manual to the different departments.</td>
</tr>
<tr>
<td>Adherence to VAT Policy is verified</td>
<td>Unclear responsibilities and tasks not performed timely and adequately</td>
<td>Quarterly, all relevant departments confirm to the Indirect Tax Manager that the VAT Policy has been implemented and the activities described herein have been performed. The Indirect Tax Manager reviews this confirmation, if applicable (VAT Policy not implemented/performed), Indirect Tax Manager takes appropriate follow-up actions.</td>
<td>Verify the Indirect Tax Manager receives confirmation on VAT manual implementation and follows-up if needed.</td>
</tr>
<tr>
<td>Monitoring</td>
<td>Unclear responsibilities and tasks not performed timely and adequately</td>
<td>The Indirect Tax Manager performs an annual audit on the VAT risk areas covered by the VAT Policy via sample testing or questionnaires.</td>
<td>Verify the Indirect Tax Manager verifies that VAT risk areas covered.</td>
</tr>
</tbody>
</table>
## Change in regulation

### Benchmark against 'as is'

### Change in VAT legislation

<table>
<thead>
<tr>
<th>Change Management</th>
<th>Normative VAT Risk</th>
<th>Normative Control Activity</th>
<th>Normative Test of control</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Changes in the legislation</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Identify all relevant changes in the VAT legislation or statutes through reference to external sources, including third party advisors and the tax authorities</td>
<td>Failure to identify all relevant changes in the VAT legislation.</td>
<td>VAT department collects information regarding changes in the legislation and reviews it for relevance to the business. Information is sought from third party advisors and the tax authorities regarding potentially relevant changes. Regular training is available to the VAT department to keep up-to-date with the legislation and practices.</td>
<td>Execution of randomly selected searches to verify if reputable third parties and tax authorities issued potentially relevant changes. Inquire about the invitation to the training and review the sign off for presence on the attendance list.</td>
</tr>
<tr>
<td>Determine the impact of the changes of the business from a VAT perspective</td>
<td>Failure to correctly interpret the VAT legislation</td>
<td>VAT department collects information regarding changes in the legislation and reviews it for relevance to the business. Information is sought from third party advisors and the tax authorities regarding potentially relevant changes. Specific process to determine the impact on the financial statements of particular interpretation of the VAT legislation and to ascertain whether a provision is required.</td>
<td>Execution of randomly selected searches to verify if reputable third parties and tax authorities issued potentially relevant changes. Periodical review by VAT department to verify if process to determine impact on financial statements is followed. Inquire about the invitation to the training and review the sign off for presence on the attendance list.</td>
</tr>
<tr>
<td>Inform the relevant sections in the business of the VAT changes and the implications of those changes</td>
<td>Financial and Compliance risk when changes to the VAT rules are not communicated timely to the business</td>
<td>Communications are drafted by the VAT department regarding each relevant change to the VAT rules and are sent to relevant parties in the business, including all business stakeholders with VAT sensitive responsibilities, e.g., accounts payable manager, accounts receivable manager, and IT manager. When necessary, a training for a business unit is organized.</td>
<td>Execution of randomly selected relevant changes to the VAT rules to verify if the VAT department has drafted communication to the parties in the business. Inquire about the invitation to the training and review the sign off for presence on the attendance list.</td>
</tr>
<tr>
<td>Where appropriate, implement the changes with the relevant systems in the business</td>
<td>Financial and Compliance risk when changes to the VAT rules are not communicated or are not communicated timely to the business</td>
<td>There is a process where each change in legislation is assessed for its impact on the systems. Verify there is a process and ownership. Assess examples of impact analysis</td>
<td></td>
</tr>
<tr>
<td>Where appropriate, implement the changes into the VAT return process</td>
<td>Financial and Compliance risk when changes to the VAT rules are not communicated or are not communicated timely to the business</td>
<td>There is a process where each change in legislation is assessed for its impact on the VAT return process. Verify there is a process and ownership. Assess examples of impact analysis</td>
<td></td>
</tr>
</tbody>
</table>
# Change in the business

## Benchmark against 'as is'

## Changes in the business

<table>
<thead>
<tr>
<th>Change Management</th>
<th>Process</th>
<th>Normative VAT Risk</th>
<th>Normative Control Activity</th>
<th>Normative Test of control</th>
</tr>
</thead>
<tbody>
<tr>
<td>All changes within the business require the involvement of the VAT department for sign off. This includes changes to the nature of the business, new products/ suppliers, new trading entities or territories, changes in structure, changes in trading model and changes to the billing/financial systems.</td>
<td>Failure to correctly implement changes in the business from a VAT perspective e.g. supply chain, markets, products, legal structure</td>
<td>Instructions to the business to involve the VAT department in any proposed changes at the planning stage</td>
<td>Inquire about the VAT department being involved in any proposed changes at the planning stage</td>
<td></td>
</tr>
<tr>
<td>The VAT department assists the relevant parts of the business in implementing the changes and in meeting any additional obligations or reporting requirements for the business as a consequence of the changes.</td>
<td>Failure to meet new obligations/ reporting requirements</td>
<td>VAT department is responsible for assisting the business in putting the proposed changes into operation. The VAT department provides written advice to the business in respect of those changes from a VAT perspective</td>
<td>The VAT department is involved in assisting the business when changes have to be implemented</td>
<td></td>
</tr>
<tr>
<td>The VAT department updates the VAT return process to take into account any relevant changes in the business.</td>
<td>Failure to optimise VAT position relating to the changes in the business</td>
<td>The VAT department is responsible for optimisation of the VAT position of the business</td>
<td>VAT department has visibility of sales VAT figures</td>
<td></td>
</tr>
<tr>
<td>Exceptions noted in the controls will be resolved but also a root-cause analysis is performed.</td>
<td>A process has been implemented in which exceptions noted will lead to a root-cause analysis and improvement projects will be started where applicable</td>
<td>Verify root-cause analysis has been performed resulting in improvement projects</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Richard H. Cornelisse*
Maintaining relationship with tax authority

**Benchmark against 'as is'*

<table>
<thead>
<tr>
<th>Change Management</th>
<th>Process</th>
<th>Normative VAT Risk</th>
<th>Normative Control Activity</th>
<th>Normative Test of control</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Maintaining relationship with tax authority</strong></td>
<td>Identify appropriate contacts at the tax authorities</td>
<td>Failure to drive the optimum relationship with the tax authorities</td>
<td>The nature of the desired relationship with the tax authorities is determined (fitting in with organisational values and strategy)</td>
<td>Verify if the nature of the desired relationship with the tax authorities is determined.</td>
</tr>
<tr>
<td></td>
<td>Maintain current contact details of the tax authorities</td>
<td>In case of urgencies, the proper person at the tax authorities cannot be contacted</td>
<td>Implement a policy/procedure regarding the relationship with the tax authorities outlining e.g. the level of information to be shared, who in the organisation can contact the tax authorities etc. Ensure one point of contact in the business for the tax authorities. Assessments from Tax authorities have been reflected in the Control environment and Monitoring role.</td>
<td>Inquire about the policy/procedure regarding the relationship with the tax authorities and the existence of one point of contact for the tax authorities in the business. Verify that results from tax assessments have been reflected in the control environment.</td>
</tr>
<tr>
<td></td>
<td>Arrange regular (as appropriate) contact with the tax authorities to discuss issues and audits.</td>
<td>Lack of visibility regarding current issues and audits</td>
<td>Maintain record of open issues with the tax authorities and status of current audits.</td>
<td>Check by VAT department if record of open issues with the tax authorities is up-to-date.</td>
</tr>
<tr>
<td></td>
<td>Regular updates within the VAT function regarding outstanding issues with the tax authorities and status of current audits.</td>
<td>Resource ineffectively consumed by tax authority audits</td>
<td>Agree audit work plan with tax authorities (where possible) to fit the resource needs of the business</td>
<td>Regularly check if audit work plan is up-to-date and evaluate the progress made</td>
</tr>
</tbody>
</table>

*Richard H. Cornelisse*
Advice to the business

Benchmark against 'as is'

<table>
<thead>
<tr>
<th>Advice to the business</th>
<th>Process</th>
<th>Normative VAT Risk</th>
<th>Normative Control Activity</th>
<th>Normative Test of control</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change Management</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business (e.g., business unit, finance function, accounts payable, accounts receivable or IT), identifies an unusual transaction or issue regarding the VAT treatment or compliance requirements relating to a transaction</td>
<td>Financial and compliance risk when failure to identify unusual transactions</td>
<td>Instructions in the business (particularly in VAT sensitive sections of the business) to refer all VAT queries to a subject matter expert. Regular communication between the VAT function and the business to build relationships</td>
<td>Verify business has been instructed to involve VAT experts in case of unusual transactions. These unusual transactions have been specified. Assess for a number of unusual transactions that VAT experts have been involved</td>
<td></td>
</tr>
<tr>
<td>Seek VAT advice regarding the issue or transaction</td>
<td>Failure to seek VAT advice when needed</td>
<td>Instructions in the business (particularly in VAT sensitive sections of the business) to refer all VAT queries to a subject matter expert</td>
<td>Inquiry about the instructions in the business with regard to VAT queries being followed and regular communication between VAT function and business takes place</td>
<td></td>
</tr>
<tr>
<td>VAT subject matter expert provides written advice in respect of issue or transaction</td>
<td>Failure to deliver adequate advice</td>
<td>Available VAT knowledge is assessed on regular basis and development and training programs are available</td>
<td>Assess there is a process to assess the available VAT knowledge fits the organization’s needs</td>
<td></td>
</tr>
<tr>
<td>Business positively confirms receipt and implementation of advice</td>
<td>Failure to implement VAT advice provided</td>
<td>Positive confirmation from the business of receipt of advice and its implementation</td>
<td>Review if positive confirmation is sent by the business for every VAT advice provided</td>
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<tr>
<td>VAT subject matter expert informs individual responsible for VAT compliance on the VAT advice provided</td>
<td>Failure to optimise VAT position in relation to a transaction</td>
<td>Instructions in the business to involve a VAT subject matter expert for all new and unusual transactions, including property or corporate restructuring</td>
<td>Inquiry about the instructions in the business with regard to involvement of VAT subject matter expert for all new and unusual transactions being followed</td>
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</table>
Other reporting requirements

Benchmark against 'as is'

<table>
<thead>
<tr>
<th>Other reporting requirements</th>
<th>Normative VAT Risk</th>
<th>Normative Control Activity</th>
<th>Normative Test of control</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maintain a record of all reporting requirements relating to the transactions entered by the</td>
<td>Failure to comply with additional reporting requirements</td>
<td>Responsibilities have been assigned and a process has been documented to identify all reporting requirements</td>
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<tr>
<td>business e.g. Intrastat reporting, EC Sales Lists, etc.</td>
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<td>Verify responsibilities have been assigned and a procedure has been documented</td>
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<tr>
<td>Collect the necessary information required at the appropriate time for the additional reporting</td>
<td>Failure to comply with additional reporting requirements</td>
<td>All reporting requirements relating to transactions undertaken by the business have been identified and communicated</td>
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<tr>
<td>requirements</td>
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<tr>
<td>Complete the necessary returns</td>
<td>Failure to comply with additional reporting requirements</td>
<td>Maintain a record (calendar) of all additional reporting requirements.</td>
<td>Periodical review by VAT department to verify if record of additional reporting requirements is up-to-date</td>
</tr>
<tr>
<td>Reconcile the information to the VAT return Information</td>
<td>Information on additional returns does not match information on VAT returns</td>
<td>Regular reconciliation between the information on the additional returns and the information on the VAT return. Differences are identified and resolved accurately.</td>
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<td>Review the reconciliations between the information on the additional returns to the information on the VAT return. Verify if differences are resolved accurately</td>
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<tr>
<td></td>
<td>Failure to comply with additional reporting requirements</td>
<td>Return is approved before submission. Segregation of duties is applied.</td>
<td>Verify segregation of duties is in place around the submission process.</td>
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</tbody>
</table>

Richard H. Cornelisse
## Configuration of accounting systems

### Benchmark against 'as is'

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<thead>
<tr>
<th>Configuration of accounting systems</th>
<th>Process</th>
<th>Normative VAT Risk</th>
<th>Normative Control Activity</th>
<th>Normative Test of control</th>
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<td><strong>Change Management</strong></td>
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<td><strong>Engagement of VAT department</strong></td>
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<td>Verify all categories of transactions have been identified. Verify there is a process to monitor any new or changed categories.</td>
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<td>Verify there is VAT determination logic in place (decision tree). Verify VAT experts have been involved in determining the correct VAT treatment for each category of transactions.</td>
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<td>**Configuration of VAT-functional</td>
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</tbody>
</table>
| Verify if VAT subject matter experts have approved the configuration of the VAT-functional elements of accounting systems and (2) testing phase is built into the project.
## Changes to VAT rates

### Benchmark against 'as is'

<table>
<thead>
<tr>
<th>Changes to VAT rates</th>
<th>Process</th>
<th>Normative VAT Risk</th>
<th>Normative Control Activity</th>
<th>Normative Test of control</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Change Management</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Identify changes in VAT rates</td>
<td>Failure to identify changes in the VAT rates</td>
<td>Information is sought from reputable third parties and the tax authorities regarding potentially relevant changes</td>
<td>Execution of randomly selected searches to verify if reputable third parties and tax authorities issued potentially relevant changes</td>
<td></td>
</tr>
<tr>
<td>Identify any required changes to VAT rate tables with accounting systems</td>
<td>Failure to update accounting systems for changes in the VAT rates</td>
<td>VAT department responsible for identifying changes in the VAT rates and communicating those changes to the relevant personnel in the business</td>
<td>Check if VAT department has identified required changes and communicated these to the relevant personnel</td>
<td></td>
</tr>
<tr>
<td>Communicate required changes to relevant personnel in the business (e.g., IT manager)</td>
<td>Unclear responsibilities and tasks not performed timely and adequately</td>
<td>VAT department responsible for identifying changes in the VAT rates and communicating those changes to the relevant personnel in the business and IT</td>
<td>Check if VAT department has identified required changes and communicated these to the relevant personnel</td>
<td></td>
</tr>
<tr>
<td>Approve changes to the VAT rate table in the accounting systems</td>
<td>VAT rate table in the accounting systems updated incorrectly</td>
<td>All changes to the VAT-functional elements of the accounting systems must be approved/authorised by VAT subject matter experts</td>
<td>Review if all changes to the VAT-functional elements of accounting systems are approved/authorised by VAT subject matter experts</td>
<td></td>
</tr>
<tr>
<td>Review changes as part of the next reporting cycle</td>
<td>Failure to update accounting systems for changes in the VAT rates</td>
<td>The list of all changes made to the VAT rates data, as included in the predefined change report, is reviewed to verify that all changes to VAT related master data are completely, accurately and timely processed, and compared with properly authorised source documents. Review is done by a delegated authority not responsible for entering master data or processing VAT related transactions</td>
<td>Verify that changes have been reviewed</td>
<td></td>
</tr>
</tbody>
</table>
### Changes to VAT condition tables or logic

**Benchmark against 'as is'**

<table>
<thead>
<tr>
<th>Changes to VAT condition tables or logic</th>
<th>Process</th>
<th>Normative VAT Risk</th>
<th>Normative Control Activity</th>
<th>Normative Test of control</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identify changes in the legislation or business which impact the VAT condition tables or VAT logic within the Accounting systems (see VAT return process)</td>
<td>Identify changes in the legislation</td>
<td>Information is sought from reputable third parties and the tax authorities regarding potentially relevant changes.</td>
<td>Execution of randomly selected searches to verify if reputable third parties and tax authorities issued potentially relevant changes.</td>
<td></td>
</tr>
<tr>
<td>Identify any required changes to VAT condition tables or VAT logic within accounting systems</td>
<td>Failure to update accounting systems for changes in the VAT legislation</td>
<td>VAT department responsible for identifying changes in the legislation and the business which impact the VAT condition tables or VAT logic.</td>
<td>Check if VAT department has identified required changes which impact the VAT condition tables or VAT logic.</td>
<td></td>
</tr>
<tr>
<td>Communicate required changes to relevant personnel in the business (e.g., IT manager)</td>
<td>Unclear responsibilities and tasks not performed timely and adequately</td>
<td>Functions and responsibilities are described within the organisation.</td>
<td>Verify whether the role and responsibilities have been described.</td>
<td></td>
</tr>
<tr>
<td>Approve changes to the VAT condition table or VAT logic in the accounting systems</td>
<td>VAT condition table and/or VAT logic in the accounting systems updated incorrectly</td>
<td>All changes to the VAT-functional elements of the accounting systems must be approved/authorised by VAT subject matter experts.</td>
<td>Review if all changes to the VAT-functional elements of accounting systems are approved/authorised by VAT subject matter experts.</td>
<td></td>
</tr>
<tr>
<td>Review changes as part of the next reporting cycle</td>
<td>Failure to update accounting systems for changes in the VAT rates</td>
<td>Advice from third parties (where appropriate) regarding the nature of the necessary changes to the VAT condition table and/or VAT logic. An edit report is generated on a monthly/quarterly basis and reviewed for changes to the VAT rate tables.</td>
<td>Execution of randomly selected searches to verify if reputable third parties have given advice regarding the nature of necessary changes to the VAT condition table and/or VAT logic. Execution of randomly selected edit reports to verify if they are reviewed on a monthly/quarterly basis for changes to the vendor master data.</td>
<td></td>
</tr>
</tbody>
</table>
## VAT element of material master data

**Benchmark against 'as is'**

<table>
<thead>
<tr>
<th>Change Management</th>
<th>VAT element of material master data</th>
<th>Process</th>
<th>Normative VAT Risk</th>
<th>Normative Control Activity</th>
<th>Normative Test of control</th>
</tr>
</thead>
<tbody>
<tr>
<td>Where a new product is introduced, provide written confirmation to the appropriate business function regarding the correct VAT coding of the material master data</td>
<td>Failure to identify introduction of new product</td>
<td>All new products require sign off from VAT department regarding material master data coding instructions to the business to involve the VAT department in any proposed changes at the planning stage. Default setting in ERP is Standard Rated. All new materials/services not attracting Standard rated VAT are reviewed on correctness. In ERP systems these materials/services could be identified by tax classification. It depends on the applied logic in the VAT determination.</td>
<td>1. Execution of randomly selected new products to verify if the VAT department has given sign off.</td>
<td>2. Inquiry about the instructions to the business to involve the VAT department in any proposed changes at the planning stage.</td>
<td>3. All new materials/services require sign off from VAT department in case of not attracting standard rated VAT</td>
</tr>
<tr>
<td>Identify changes in the legislation or business which impact the VAT coding of the material master data</td>
<td>Failure to identify changes in the legislation</td>
<td>Information is sought from reputable third parties and the tax authorities regarding potentially relevant changes. Regular training is available to the VAT department to keep up-to-date regarding the legislation and practices.</td>
<td>Execution of randomly selected searches to verify if reputable third parties and tax authorities issued potentially relevant changes. Inquire about the invitation to the training and review the sign off for presence on the attendance list.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Identify any required changes to the material master data</td>
<td>Failure to correctly code the material master data</td>
<td>An edit report is generated on a monthly/quarterly basis and reviewed for changes to the material master data</td>
<td>Execution of randomly selected edit reports to verify if they are reviewed on a monthly/quarterly basis for changes to the material master data</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Approve changes to the material master data</td>
<td>Failure to update accounting systems for changes in the VAT legislation</td>
<td>An edit report is generated on a monthly/quarterly basis and reviewed for changes to the material master data</td>
<td>Execution of randomly selected changes to verify if review has taken place as part of the next reporting cycle</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Review changes as part of the next reporting cycle</td>
<td>Failure to update accounting systems for changes in the VAT legislation</td>
<td>The list of all changes made to the VAT material master data, as included in the predefined change report, is reviewed to verify that all changes to VAT-related material data are completely, accurately and timely processed, and compared with properly authorised source documents. Review is done by a delegated authority not responsible for entering master data or processing VAT related transactions</td>
<td>Verify the change report is reviewed on a periodic basis</td>
<td></td>
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</tr>
</tbody>
</table>
Indirect Tax Management Framework

Managing risk is about making decisions at all levels of an organization, to limit the effect and likelihood of threats happening and to increase the effect and likelihood of opportunities.

A company’s tax control framework that meets generally accepted control standards provides:

- insight into the areas prone to VAT risks (awareness),
- management has established the extent to which it is prepared to accept risks, and
- internal controls have been implemented that are appropriate given the material risks identified.

A Tax Control Framework (TCF) is an internal control instrument specifically aimed at the tax function within a company and an integral component of a company’s business control framework, which is different for every organization. It is a system (process) to identify, mitigate, control and report tax risks. The ultimate objective of a TCF is to be in compliance with tax laws and reporting requirements and manage the risks that exceed the companies’ risk appetite.
Why is VAT important?

Benchmarking exercises against trends in the indirect tax market can be done via global surveys that capture info on tax function, attitudes and priorities. These surveys are useful as they give insight into what others are facing or have faced and how you could improve yourself. According to big4 surveys, the related control mechanisms are still inadequate.

Not only can an error in the accounts lead to major additional tax assessments and substantial penalties, with amounts like these, it can be devastating for the reputation of a listed company.

The global benchmark study on VAT / GST of KPMG among multinationals (clients and relations), inter alia, shows that most companies haven’t yet developed an effective VAT/GST approach.

‘The chance that the tax authorities will issue additional assessments and penalties in the near future because errors in indirect tax are detected, increases by the day.’

Risk management and governance

Tax authorities, due to technological innovations, have become increasingly better in executing their tax audit. They collect and analyze already indirect tax data (e.g. SAF-T for VAT). The focus is not only about timely and accurate VAT reporting but as well whether on high risk areas an effective tax control framework is in place.

The surveys of the Big4 are clear: we are talking about extremely large amounts of money that lack appropriate control, but because KPIs have never been developed for this particular purpose, the risks are often not visible and thus not monitored.

Ownership is often lacking around indirect taxes as no one is actually responsible for the entire end-to-end process causing operational gaps most visible when (cross border) changes occur. However, according to these surveys CFOs / Head of Tax apparently still focus more on direct tax than indirect tax.
At multinational companies we’re easily talking about amounts of over 5 billion euros of indirect tax flowing through the books. According to big4 surveys, the related control mechanisms are inadequate. Not only can an error in the accounts lead to major additional tax assessments and substantial penalties, with amounts like these, it can be devastating for the reputation of a listed company.

**Shift from direct tax to indirect tax**

**VAT accounts for more than 20% of total tax revenue**

CFOs / Head of Tax apparently focus more on direct tax than indirect tax. This is interesting as from a tax revenue perspective the current trend is a shift from direct tax to indirect tax by decreasing direct tax rates and increasing VAT/GST rates.

Corporate income tax rates are continuing to fall in many countries. Global indirect taxes can amount to as much as 75% of the overall corporate tax burden, with VAT and sales/use tax outlays nearly 40% of total business tax expenditures — almost twice as much as corporate income tax.

More than 160 countries have a VAT regime. In the EU, between 2008 and 2013, the average EU standard rate increased from around 19.5% to more than 21%. The EU average VAT rate is now approximately 21.5%. VAT accounts for more than 20% of total tax revenue (OECD).

Not only are the amounts in the indirect tax cycle continually rising internationally, these surveys also reveal that the tax authorities, due to technological innovations, have become better at executing their tax audit.

*Netherlands: Tax revenue in 2015 - Indirect tax revenue in NL was in 2015 EUR 74,9bn compared to Corporate Income Tax EUR 21,3bn. Wage tax and income tax was EUR 133,7bn.*
A cash in and a cash out?

VAT is a tax on consumption. It is collected in stages by the businesses (or intermediaries) and is fully borne by the final purchaser. As a consequence, VAT is a transactional tax with the potential to impact all transactions with suppliers and customers.

Measuring risks is often based on the balance between output VAT and input VAT and not on the total amount of VAT/GST throughput (VAT numbers ‘under management’).

The findings listed above are not surprising as often the question is asked what risk management even has to do with VAT/GST. The reasoning behind this question is that VAT/GST is typically cost neutral for most businesses: “a cash in and cash out” scenario. However, every indirect tax function knows that deductible input VAT and liable output VAT have to be managed separately to avoid substantial VAT assessments, penalties and interest payments.

It is a risky business to monitor only the balance between output VAT and input VAT. Neutrality can only be achieved – better is the word ‘earned’ – if certain formal and material requirements are met.

It starts with the people in the organization becoming aware of the amounts that are at stake and the risks of something going wrong. Benchmark studies repeatedly create the same picture: too little control, too few KPIs and when a mistake is made in the control, it usually concerns large amounts of money.

'A mistake of one percent can make the difference between profit and loss for a multinational company. Explain that to your shareholders.'

Financial impact: an AR & AP example

Above the line costs

The supplier is responsible for ensuring that all the conditions for applying the zero VAT rate are met. If not, the tax authorities will seek to recover tax due from this supplier via a levy of a tax assessment. If the applicable VAT rate is 25%, the tax assessment will be 25/125 of the consideration charged. This assessment has to be increased with interest and penalties to determine the total tax burden.
Something as basic as a billing error leading to invoices issued in the wrong name could not only delay revenue receipt but also result in non-recoverable VAT. The penalties for incorrect invoicing can be a percentage of the turnover, so amounts can quickly become material—up to 25 percent VAT in Europe (Hungary 27%) on the turnover plus penalties.

In many countries indirect tax returns are not audited by the tax authorities. Tax certainty about tax positions taken will exist once the statutory time limits are exceeded. That might change when e-audits approaches are standard implemented as audit method or other VAT fraud measures come into force.

A single operational failure in the systems and processes that manage the flow of indirect taxes through the supply chain can have significant consequences in terms of additional assessments, penalties, blocked VAT refunds and delayed payments from customers.

Overview of some root causes

<p>| | |</p>
<table>
<thead>
<tr>
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<tbody>
<tr>
<td>1</td>
<td>A process failure (either within or outside of the accounting system) to apply the correct VAT liability to a transaction (either not charging VAT when it should be, or charging VAT when it should not be)</td>
</tr>
<tr>
<td>2</td>
<td>A failure to identify a requirement to register for VAT within a jurisdiction (establishment is often unnecessary in creating an obligation – a mere sale of goods can be sufficient to create an obligation to register for VAT);</td>
</tr>
<tr>
<td>3</td>
<td>A failure to evidence the non-application of VAT to a transaction, e.g. lack of export documentation, etc;</td>
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<tr>
<td>4</td>
<td>A failure to account for VAT on intercompany transactions;</td>
</tr>
<tr>
<td>5</td>
<td>A failure to reconcile VAT turnover to AR;</td>
</tr>
<tr>
<td>6</td>
<td>A rejection of a VAT credit through AP because of invalid documentation, e.g. the purchase invoice to support the credit was missing or defective;</td>
</tr>
<tr>
<td>7</td>
<td>A failure to claim credit for VAT charged at importation;</td>
</tr>
<tr>
<td>8</td>
<td>A failure to self-assess VAT on the receipt of services from a non-resident or on transfers of goods from one EU Member State to another.</td>
</tr>
</tbody>
</table>
Personal liability and criminal charges and jail time

59 percent of respondents of a Big4 study (53 percent in 2014) expect the personal liability of compliance officers to increase in 2015, with 15 percent expecting a significant increase.

*Compliance officers or its executives at firms as diverse as Swinton Insurance, Bank Leumi, Bank of Tokyo-Mitsubishi, Brown Brothers Harriman and Deutsche Bank (DB: VAT fraud) having been fined, banned or jailed (or a combination).*

More often tax and public prosecutors’ offices file criminal charges for tax-related scenarios with consequences for not only the businesses reputation but also the executives and employees that are jailed.

Prosecutors said they were investigating 25 bank staff on suspicion of severe tax evasion, money laundering and obstruction of justice, and searched the headquarters and private residences in Berlin, Duesseldorf and Frankfurt.

"Two of Deutsche Bank's Management Board members were involved in the investigations as they signed the value-added tax statement for 2009," Deutsche Bank (DBK Gn.DE) said in a statement.
Awareness and acceptance by senior management

Create, protect and prove value and write a business case for investment to realize business objectives such as improve cash flow, reduce costs, improve tax processes and manage tax related risks.

A key business objective in today’s complex regulatory environment is the promotion of shareholder confidence in a company’s financial statements. Finance functions of major multinationals operate within a corporate culture that places increasing emphasis on the core values of trust and integrity.

Within this culture the overriding strategic imperative of many CFOs is to manage their company’s financial reporting obligations and avoid reputational risks. It is essential that the tax function has an excellent relationships with the business, senior management, finance and IT as a mutual understanding of the impact of the company's tax challenges and solutions should exist to realize that investment budgets are actually made available.

As organization structures or maturity levels are not the same, the startpoint could for every company be different. Important is from a business and finance perspective is that the financial reports are studied and when available investors calls are attended to get a grip of the company compliance statements, business objectives and strategy. The information gathered could support your own business case for establishing change.

Effectiveness and efficiency of operations, the reliability of tax reporting, and compliance with applicable laws and regulation.

Best practice would if a tax function of a company works under the same competitive market principles as external tax advisers and that the in-house customers are the executive management, finance, procurement, IT, logistics, internal audit, HR, legal etc. That would mean that you have to invest in relationships and develop an in-depth understanding of their business needs. Logical as customer satisfaction is realized by
managing the expectations and relationships of internal customers, tax authorities, external auditors and other stakeholders.

A “customer” of the tax function may be another department, an outside provider, or another operating unit within your organization. First you should assess the conditions for client satisfaction of senior management (C-level) as they are your (end)customer.

**Buy-in from all relevant stakeholders**

Based on the survey findings it seems that C-level executives consider indirect tax of lower priority than the indirect tax function generally does.

*Is the root cause misinterpretation or not understanding and speaking the same language?*

If you want to improve quality, you have to first understand what senior management thinks is important, and what senior management thinks of you. Anyone who has to work with other people knows that figuring out what makes them tick is the key to getting what you need and want.

That means optimize overall indirect tax performance is only possible in an effective way through understanding the role and needs of the finance function and/or head of tax.

*Demonstrate reasons for change, which problems are the most important to solve.*

The next step – to achieve mutual understanding – is to get agreement with senior management at the level of indirect tax risk appetite of the company in the worst-case scenario:

1. Review the categories of VAT risk the company is facing as well as the likelihood of occurrence, its potential impact and mitigation measures
2. Review the company's risk appetite and risk tolerance and the way in which risks is measured
If you know the risk appetite, you have to identify the lowest performing VAT processes that have the most direct impact on the company’s business objectives (e.g. benchmark and measure), short problem statements for the gaps found should be written.

Indicate how long the problem has been going on, describe the gap between the current and desired state, describe the impact of the problem, perceived solution or root cause. It should also include an estimate of savings or the amount of hours currently lost due to rework. Use the scientific method we learned at university:

- Identify a problem,
- Measure its magnitude,
- Determine why the problem exists, and
- Generate a set of solutions to ensure that the problem goes away

These statements can subsequently be prioritized and validated with senior management. Various solutions are presented with cost-benefit analysis, so a constructive discussion with senior management can be held about what is needed to close these gaps (e.g. budget and/or resources needed or necessary for change of systems, processes and controls etc.).

*In the worst case the gap(s) will not be closed, but at least you have achieved mutual awareness and hopefully responsibility.*

If the problem is material and addressed in the right way it will more than likely be dealt with accordingly, because it has now become a mutual responsibility.

It is the responsibility of management to identify the key processes of their organization, measure their effectiveness and efficiency, and initiate improvement of the worst performing processes. Therefore start with a small project and use a successful pilot to demonstrate potential and gain further buy-in from senior management to support new follow-up initiatives.
Summary

<table>
<thead>
<tr>
<th>Roadmap to realize senior management buy-in</th>
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</thead>
<tbody>
<tr>
<td>1. To achieve mutual understanding – is to get agreement with senior management at the level of indirect tax risk appetite of the company in the worst-case scenario</td>
</tr>
<tr>
<td>2. <strong>Define</strong> - understand the categories of VAT risk the company is facing as well as the likelihood of occurrence, its potential impact and mitigation measures</td>
</tr>
<tr>
<td>3. <strong>Measure</strong> - perform zero measurement on the company’s top VAT risks</td>
</tr>
<tr>
<td>4. <strong>Analyze</strong> - identify a problem, measure its magnitude, determine why the problem exists, and generates a set of solutions to ensure that the problem goes away</td>
</tr>
<tr>
<td>5. <strong>Analyze</strong> - identify the lowest performing indirect tax processes that have the most direct impact on the company’s business objectives.</td>
</tr>
<tr>
<td>6. <strong>Improve</strong> - write a business case and short problem statements for the gaps</td>
</tr>
<tr>
<td>Indicate how long the problem has been going on, describe the gap between the current and desired state, describe the impact of the problem, perceived solution or root cause. It should also include an estimate of savings or the amount of hours currently lost due to rework</td>
</tr>
<tr>
<td>7. <strong>Improve</strong> - present various solutions so a constructive discussion with senior management can be held about what is needed to close these gaps</td>
</tr>
<tr>
<td><strong>Budget and/or resources needed or necessary for change of systems, processes and controls etc.</strong></td>
</tr>
<tr>
<td><strong>Risk acceptance</strong> - worst case the gap(s) will not be closed, but at least you have achieved mutual awareness and hopefully responsibility</td>
</tr>
</tbody>
</table>
Sound audit defense

Tax audits could be very time consuming and have a huge impact on resources or external advisors. Be therefore prepared and minimize the risk that extensive resources have to be allocated when a audit is held by getting already a clear understanding of the material tax risks (risk based approach), visibility of the related processes and controls, its weaknesses and strengths (e.g. zero measurement as simulation of a tax audit), identify the evidence supporting tax positions taken and document in such a way that will be easy accessible again when actually needed (audit trail / workflow management).

A transparent relationship with tax authorities might resolve any disputes faster.

Based on the above it is recommended to define and outline a tax audit strategy and set a protocol for:

- Company's code of conduct respectively rules of engagement during an audit (the do's and don'ts)
- Project plan and resources needed (roles & responsibilities)
- Preliminary audit findings (amount of assessment and fines)
- Voluntary disclosure for example to avoid prosecution for tax fraud or joint liability
- Exchange of information such as answering queries and provide information respectively data
- Holding the final meeting
- Litigate and how and when to settle
- Managing essential deadlines (e.g. objection procedures, appeals to District Courts, Courts of Appeal and Supreme Court, etc.)
- Implementing audit findings in new processes and controls
- Document audit findings from preliminary to final audit findings (gap and explain the gap)
Avoid disputes and manage risk

**Tax positions are properly disclosed, presented and documented**

Tax controversy considerations and requirements should be built into the preparation of the indirect tax return and those responsible for indirect tax controversy should mandatory review indirect tax returns to verify that indirect tax positions are properly disclosed, presented and documented. It is also about 'being tax audit ready' such as simulation tax audit analysis to anticipate on any actual tax audit outcome. It is something you could - in a proactive manner - prepare for.

**IT systems for e-audits**

**Tax audits via data analytics**

Not only finance and tax but also the tax authorities might request access to systems and use data analysis tools to highlight how transactions are processed and how IT systems are VAT configured. Data integrity is therefore becoming a greater risk factor when transactions are booked in any given country and are not properly evaluated for tax purposes.

It could also be that the financial data in the system does not reflect the business model design or that any change of the business is not properly managed.

**A new trend: tax authorities and standard audit files for tax purposes**

*Tax authorities, due to technological innovations, have become increasingly better in executing their tax audit.*

The probability that the tax authorities will issue additional assessments and penalties in the near future because errors in indirect tax are detected, increases by the day.’
The OECD has issued in May 2005 a guidance note on the development of Standard Audit File –Tax (SAF-T) and recommends the use of SAF-T as a means of exporting accurate tax accounting data to tax authorities in such way that can it can be analyzed easily.

It is best practice that before information is provided to the authorities, a company performs a risk assessment and determines the worst case scenario to avoid unforeseen tax risks and makes copies of any information provided.

What if there are glitches in your data, input errors, empty fields, awkward descriptions in fields or apparent inconsistencies?

A non exhaustive checklist re submitting data to the tax authorities

- Has data been analyzed and a tax risk assessment performed?
- What are the tax authorities doing with this data: perform data analysis?
- If not impacting the present does is the company aware that it leaves behind an audit trail that can be retroactively be investigated and backfire to tax position taken and result in ammunition for contra arguments, increase of penalties?
- If the data provided does not meet the required data format could this result in a higher risk of a tax audit
- To avoid unanticipated risks or mitigate this risk is it not necessary to perform a data analysis or VAT configuration review prior to submitting data as an internal pre-audit as the source of the data request is the company’s ERP system?
A roadmap for a documented indirect tax strategic plan

A relevant indirect tax strategy—correctly implemented—will allow the new business to function effectively from go-live, from both a tax and commercial perspective, so that it can move inventory, generate sales and invoices, face fewer disputes with non-paying customers, remain tax compliant, and integrate the business on time and on budget.

“No vision is worth the paper it’s printed on unless it is communicated constantly and reinforced with rewards.”
Jack Welch

With indirect taxes intertwining through the day-to-day operations of a company—raising sales invoices, moving inventory, paying suppliers, collecting cash—indirect tax risk can have a distinct and domino-like effect on the commerciality of an organization.

Overview

In response to increased scrutiny from senior management, tax administration and other regulators, many businesses are now formally documenting their indirect tax strategy and implementing formal processes to evaluate and approve planning ideas.

"A strategy may be defined as a plan or method for obtaining some goal or result. The responsibility of management to identify the key processes of their organization, measure their effectiveness and efficiency, and initiate improvement of the worst performing processes."
For leading companies, a tax strategy is a dynamic framework that is shaped by internal and external drivers. An indirect tax strategy should cover all business locations and should be aligned to the overall business strategy.

The benefits of a documented strategic plan

Potential benefits of a documented indirect tax strategy include:

- Obtaining clarity around the business’ indirect tax risk appetite, which should facilitate the identification of planning opportunities appropriate to the business' wider commercial objectives
- Providing the business with a consistent and efficient review and evaluation process over tax-related matters
- Raising the profile of indirect tax with key business and finance stakeholders
- Monitoring and strengthening governance procedures in decentralized and overseas jurisdictions
- Identifying improvements in indirect tax-related systems, processes and controls
- Identifying areas where additional indirect tax resources or funding may be required

The indirect tax preparation and roll out process may involve:

- Initial scoping to confirm the relevant stakeholders and to clarify the objectives of the project. At this stage the Board’s expectations on indirect tax performance and indirect tax risk appetite should be considered
- Workshop attended by indirect tax and key business and finance stakeholders. Workshop discussions will include overall business strategy, indirect tax risk appetite, stakeholder requirements from Tax, indirect tax function objectives, and planning evaluation and review processes
- Indirect tax strategy document to be drafted, reviewed, agreed with key stakeholders and approved by the Board
• Roll-out of the strategy to entire tax and the wider business to ensure a shared understanding of indirect tax risk appetite and acceptable planning. The roll-out may include workshops and conference calls with Tax, Finance and the business.

• At this stage the most appropriate formats for the strategy document should also be considered. These may include a strategy document stored on the Intranet, an interactive decision tree to evaluate planning, hard copy tax guidance manuals etc. To move the (indirect) tax strategy from paper into practice the roll-out may also include organizational changes, and improvements to processes and systems.

• Ongoing review and update of indirect tax strategy and documentation, and ongoing indirect tax strategy effectiveness reviews.

Scope of work

The strategy and the group’s overall approach to indirect tax compliance, risk management and indirect tax planning should be clearly documented, signed-off by senior management and regularly reviewed to ensure that consistent minimum standards are defined and implemented.

The approach should also implement an effective communication plan, as part of the change management process, to ensure all impacted entities understand what is required of them and clarify their commitment to the strategy.

Group business strategy and indirect tax objectives

Document and challenge the overall indirect tax strategy of the group to ensure there is clear linkage to the business strategy and how the indirect tax strategy contributes value to the business’s overall objectives.
Risk management

Risk management - strategic objectives
Define the indirect tax risk management framework of the group covering processes both within and outside the tax function. This includes the development and maintenance of a group indirect tax risk register, and the review & oversight of processes of decentralized and overseas locations.

Define the group’s overall indirect tax risk tolerance parameters which should be applied to all significant transactions.

Governance and performance

Strategy oversight and sponsorship
Define the principles and policies on which the group’s indirect tax processes are based. It should also include the process on how the strategy will be approved by the Board and communicated to the business.

Management reporting of indirect tax risk
Describe the reporting lines and its frequency from the operating teams to senior management e.g. indirect tax to Head of Tax, the CFO and Board/Audit Committee. Reporting should cover key indirect tax compliance and the reporting of issues globally including significant transactions and tax administration audits.

Define the reporting processes from overseas and decentralized locations to the group indirect tax function relating to compliance, transactions, audits and exposures.

Indirect tax objectives and key performance indicators
Define the KPIs for the indirect tax function to show indirect tax performance Indirect tax function KPIs should include performance measures on people, efficiency, growth and quality.
**Relationship with tax administration**

Describe the requirements for dealing with the external tax regime, including who has authority to negotiate with the tax authorities in relation to potential audits and penalties.

**People and organization**

**Roles and responsibilities and reporting lines**

Outline the indirect tax related roles and responsibilities (including review and reporting lines) of the Group including, but not limited to, the following stakeholders: the Board, Chief Financial Officer, Head of Tax, Business Units, Finance team, Tax Function, Local indirect tax teams, etc.

**Resourcing**

Define the skills and roles that are required to deal with indirect tax matters in each location. Document career development, role rotation and succession planning processes.

**Training**

Describe the indirect tax training requirements for staff, and the awareness training to be provided by indirect tax to the finance and business teams and other stakeholders (e.g. procurement, IT, logistics, internal audit, HR, legal).

**External tax advisors**

Provide guidelines on the use of external advisors (i.e. for industry insights, technical updates, and input and to cover skills and resource shortages) and the authority to approve the use of external advisors in various jurisdictions.

**Alignment with business units**

Describe the responsibilities, quality levels, controls and reporting between indirect tax and the business units and ensure this is properly represented in Service Level Agreements.
Process and controls

**Indirect tax planning and significant business transactions**

This should cover non-routine or significant transactions and the requirement for review & approval by the indirect tax function prior to execution of the transactions. It may also be appropriate to include more detailed guidelines around the type of indirect tax planning and whether this is allowed according the business’s tax policy.

These guidelines should be approved by senior management and may include issues such as the likelihood of tax administration to challenge and litigate the potential change to the group’s indirect tax risk profile and key reputational risk issues.

This may also cover documented planning evaluation and acceptance criteria, planning implementation review processes and an ongoing planning review and monitoring processes.

Describe the requirements for other stakeholders (e.g. finance, procurement, IT, logistics, internal audit, HR, legal) to seek Indirect Tax input early in the process.

**Indirect tax compliance and financial reporting**

Describe the requirements of the group related to indirect tax compliance and financial reporting (i.e. data gathering and review, and preparation and review of indirect tax returns and provisions) across all jurisdictions.

It may also be appropriate to document specific responsibilities, controls and systems in relation to each process.

**Internal auditing of indirect tax**

Describe the internal audit program, including any processes, policies and tools used, for indirect tax focusing on the testing of effectiveness of internal controls for key risk areas.
Finance and business systems and data

Describe the finance and business systems used and the requirement for indirect tax training and input in relation to accounting and business systems (e.g. review of indirect tax set-up of accounting systems and indirect tax involvement in business system upgrades to ensure global consistency in their application).

Indirect tax systems

Describe the systems used by the indirect tax function including how they control the integrity of data used for indirect tax filings.

Workflow information and management

Document in detail the indirect tax operating processes and procedures including workflow and information management, resourcing and technology requirements.

Reporting and workpapers

Define the detailed preparation and retention guidelines for both paper and electronic documents. It may be appropriate to include guidelines on mandatory archiving.

Tax function framework document

A tax strategy document is complemented by a tax function framework document describing the roles and responsibilities of the tax function and a tax policies document describing the policies developed and used by the tax function.
Structure the tax function

The tax function should be able to understanding business activities/objectives including R&D and get aligned with other functions like legal, HR and IT. The tax objective is to mitigate risk and identifying opportunities to support company's supply chain.

As Is' situation to benchmark at. Does it fit or not?

A common factor among organizations with an increased risk profile is often the absence of a clear strategy to manage both the technical and operational risk issues associated with indirect taxes. Most major multinationals include one or a few more VAT specialists within the tax function.

However, the way in which organizations seek to utilize this specialism tends to mirror the traditional consulting model: 'the specialist adviser holds a central position within the tax function, responding to individual queries raised by logistics managers, accounting staff and local business units.'

The role is often a reactive one, relying on the ability of colleagues with an operational or local market focus to identify potential areas of indirect tax risk and refer them to the tax department for specialist review.

As a consequence, central visibility of the VAT compliance issues affecting local country operations tends to be inconsistent at best, with little or no continuity in the management of local VAT risk across the enterprise.

A further limitation on the effectiveness of the in-house VAT adviser is that he or she tends to focus on technical questions of strict VAT liability, rather than on the operational issues affecting the integrity of transactional reporting. An increasing number of in-house VAT managers however are facing the challenge of creating an indirect tax strategy that is more closely aligned with the business objectives of operational integrity.

Within most organizations there is often no single person or department responsible for the end-to-end VAT accounting process. The finance department owns often overall responsibility for the sales and purchase processes, but the application architecture underpinning those processes is configured and maintained by the IT department.
The control environment surrounding manual intervention in the accounts payable and receivable processes remains the responsibility of the finance department. VAT-critical processes such as PO creation, invoice verification and AP tax code selection are subject to limited or inappropriate controls, while the attention of the internal VAT function remains focused on the provision of ad hoc advisory support to local business units.

Despite the potential impact of VAT errors on the audited accounts, the financial reporting responsibility of the in-house VAT specialist tends to be limited to VAT returns and associated filings (eg. EC Sales List, Annual Sales Listings, Intrastat).

**Looking back - what has changed over the years?**

For a long time, the indirect tax profession has been an individual sport. Due to changes in the tax market and in client needs, the tax profession has evolved into more of a team sport.

**The changing world from an adviser's perspective**

What is different nowadays?

When I started around 20 years ago, indirect tax specialists were scarce, there were hardly any in-house indirect tax functions and content, which nowadays is freely available on the Internet, could still be sold.

"In the land of the blind the one-eyed man is king"

An adviser could work more reactively. A comparison can be made with a doctor who has patients in the waiting room, can diagnose the patients, can find the problem and can then prescribe some pills to remedy the situation. We had full access to all kinds of VAT planning schemes, and the tax profession—both the buyer as the seller—was much more product-focused.

As advisers, we were targeting new patients. Many consultancy firms companies sold VAT content-based knowhow. In the past, that system was closed. Only a few organizations had access to specific content - often gathered via their worldwide network of people. At that
time and under those circumstances, the content still represented significant added value for the client and therefore market value.

The system evolved from closed to open due to internet innovations such as search engines, and more people started to contribute and share content. Information can be posted, forwarded, shared and communicated. This is all free of charge. All kinds of content can be searched, found quickly and is available 24/7 as long as you have internet access.

Let’s do an exercise. Look back 5-10 years ago and think about the basic content that clients were willing to pay for and that content providers are now providing free of charge. Use Google’s search engine and enter that same question.

**What do you see?**

Google probably already has the answer to your question. The consequence is that prices are going down and that the life cycle for this kind of paid product is at an end. Everybody can search and find it himself. The current impact of Google and Wikipedia is already huge since, from a pricing perspective, much content has become less valuable or even worthless.

When I started, the (starting) salaries were much lower, and that meant lower charge-out rates. Increased salary is one of the reasons why tax professionals now must grow up more quickly. A higher salary means a higher charge-out rate, and from the client’s perspective, a higher bill means higher expectations.

**We must deliver higher quality and higher practicality; that is just a fact of life.**

**The changing world from the client perspective**

In addition to the introduction of anti-abuse law, clients themselves (and their needs) have also changed. To continue our analogy of the doctor, the patients have become doctors themselves by setting up their own in-house indirect tax functions.
Thanks to tax industry networks and social media, tax knowledge is shared and communicated within the industry. The result is that the service and the ability of an external adviser have had to evolve as well. Changing client needs have also resulted from factors, including:

- Globalization
- The use of tax technology
- Scandals such as the global credit crisis and Enron
- Increased tax authority scrutiny (e.g. standard audit file for tax purposes)
- Rapidly evolving global tax landscape such as global tax legislation and regulation resulting in tax transparency (e.g Country-by-Country Reporting / OECD’s Base Erosion and Profit Shifting / Accounting Directive), new tax norms, new reporting requirements, new key performance indicators
- Automatic Exchange of Information in Tax Matters, etc.

Discussions regarding accountability put both the external adviser and the in-house indirect tax function in a more proactive mode.

**Add new talent, skills and competencies**

Because of these changes, technical tax expertise has become more a basic skill from the adviser’s perspective. Data analytics, IT and accounting capabilities as well the soft skills of the adviser are—and will become—the key differentiator. Due to all of the technological developments, this is already part of our present and future.

Technical tax advice must be implemented in systems, processes and controls. Instructions must be given to people who are outside of the tax function. Data has to be analyzed in an efficient and effective manner not only to measure the past but as well to predict the future. Alignment with the business is essential for the tax function to plan in a timely manner and to avoid future firefighting.
In order to challenge and support a client in his mission, an adviser should possess—in addition to excellent technical skills—a clear understanding of communication and collaboration, analytical/critical thinking, project management, change management, information technology, negotiation and leadership. All of these skills are needed in order to be successful.

The indirect tax profession has been an individual sport for a very long time. The profession is still about the individual’s technical tax strength and personal practical experience, and the future generation of advisors are often trained by that individual.

Get the right people in the right roles

It is my opinion that the indirect tax professional of the future will need to take a different approach.

Why?

It is simply no longer possible to excel at everything regarding global indirect tax management. Thus, some people can excel in certain areas of indirect tax, and the overall outcome of the team’s effort will make the real difference from a quality standard perspective.

*In other words: "One man's weakness, is another man strength, so let's team up*
- Richard Cornelisse

The indirect tax department needs to consist of the right number of tax personnel and the right level of skills and capabilities to be successful.

According to survey findings the size of the indirect tax team size is often (too) small. Direct tax has not only more staff but are often better positioned.
If the Head of Tax and the indirect tax function would figure out how to cooperate more efficiently, they will also bring indirect tax more into the spotlight of the CFO. In order to realize the mission statement in the title of this paragraph the following also needs to be assessed to test whether set objectives can be actually realized.
M&A integration: managing the moving parts before, during, and after a transaction

A relevant indirect tax strategy—correctly implemented—will allow the new business to function effectively from go-live, from both a tax and commercial perspective, so that it can move inventory, generate sales and invoices, face fewer disputes with non-paying customers, remain tax compliant, and integrate the business on time and on budget.

With indirect taxes intertwining through the day-to-day operations of a company—raising sales invoices, moving inventory, paying suppliers, collecting cash—indirect tax risk can have a distinct and domino-like effect on the commerciality of an organization.

The impact can increase exponentially in the event of a merger or acquisition. But do these taxes and tax planning opportunities get the attention they need, especially in light of increasingly complicated and globalized business models?

In a simpler time, due diligence for the purchaser typically focused on identifying, assessing, and quantifying historical indirect risks. The aim was to provide insight into these risks and build into the contract adequate coverage in case (risk) history repeated itself.

Armed with this information, the buyer could negotiate a reduction of the selling price or secure indemnification from the identified risk.

The tax advisory input also would extend to opportunities inherent in the deal structure. With effective planning, deal costs would cascade down the group to sit in an appropriate entity for commercial and corporate income tax deduction purposes, and value-added tax would not “stick” as an unrecoverable cost—at a rate of up to 25 percent in the European Union (Hungary even 27%).

Richard H. Cornelisse
Asset deals are less rigorously subject to tax due diligence: The historical risk usually remains with the seller and the buyer takes on only the risks directly associated with the assets (e.g. VAT adjustment period). In cases where all the assets qualify as a business going concern, the transfer might not be subject to VAT. The seller would not have to charge and report VAT, the buyer would not have to pay or deduct VAT, and both parties could see a cash flow advantage.

Transactions in today’s business world

Even as the world is shrinking, businesses and their growth strategies are becoming more complicated. A schematic drawing of the functions of a typical multinational today might look like a Rube Goldberg contraption—a complex of moving parts that must connect one to another for tax, regulatory, and reporting purposes.

And unlike the more contained structure for handling income-based taxes, responsibilities and key drivers for indirect taxes may be spread throughout the enterprise, residing not just in the tax department but in any of such diverse departments as finance, information technology, supply chain management and logistics, human resources, and beyond.

Added is the growing trend toward shared service centers (SSCs) that are responsible for operational processes including accounts payable and accounts receivable as well as other outsourced functions for tax, finance, and treasury.

*Tax determination and reporting for the entire operation may be governed by one or more enterprise resource planning systems, which in turn may be integrated to varying degrees, with or without the benefit of sophisticated technology tools.*

All these factors make for a changing and increasingly sophisticated business environment that requires a different approach to business indirect tax advice. Although fundamental tax due diligence is still a requirement for the purchase of a company or assets, it is only the opening chapter. Equally important are exploring and thinking through options for structuring the indirect tax profile and how it will function in the organization post acquisition and throughout implementation and integration.
A look at some critical questions

Asking the critical questions—whether of outside advisers or company leadership—can help focus on the relevant issues in these areas of particular importance.

**Processes and controls, history and knowledge**

- What are the new processes and controls going to be?
- Who owns these controls?
- Will the tax knowledge of the acquired business be retained or will there be key staff resignations?
- What technology will be retained?
- Who is aware of the tax planning history and can help make sure that the proper structures are maintained?
- How will the seller’s processes and systems be integrated?

**The new structure and VAT**

- Should VAT be charged on the sale? If so, what country’s VAT should be applied and at what rate?
- Who is liable for any VAT chargeable, and if chargeable can this be deducted?
- Who is responsible for VAT errors and penalties?
- How will inventory be integrated into the new purchaser’s supply chain?
- Will using a classic principal structure in the new entity help keep maximum profits in low-tax jurisdictions? If so, one entity will own title to inventory throughout the various jurisdictions and the principal would require a VAT registration in each location where inventory is held.
• Where will the regional inventory hubs be located? Careful planning of the hub locations will allow VAT on import to be deferred to a point where it no longer represents a cash flow cost to the business. Conversely, poorly implemented “virtual” VAT inventory systems can have the opposite effect: With each national entity able to move its own goods to a foreign jurisdiction, ostensibly to maintain a minimal level throughout the region, the actual result could be that every national subsidiary would require a VAT registration in every other European jurisdiction.

• Are U.S. foreign tax credits to be used with transactions occurring outside the United States? A VAT registration is generally needed where inventory is held. In some countries, particularly those in Asia and Latin America, a VAT registration will crystallize a permanent establishment for corporate income tax purposes. This would mean a massive increase in the U.S. corporation’s foreign tax compliance obligation and could substantially increase the amount of tax due as well as the workload.

• Where will the deal costs sit? Deal costs are generally cascaded so that the corporate income tax deduction can be taken at the appropriate entity. But when the cost remains in a holding company, VAT will be an absolute cost to the transaction.

What happens to VAT when the business model changes?

A change in the business model can actually create VAT risks. For example, the selling arrangement may change from a buy/sell to broker/agent or vice versa. Goods purchasing may become centralized. The flows and storage locations of goods may change.

*In any of these cases, new VAT registration obligations may be created in different countries.*

Likewise, VAT could be chargeable by different entities and the recoverability of the VAT could change, and different billing flows are created.
Accounts Payable/Accounts Receivable

As the acquisition integration continues, something as basic as a billing error leading to invoices issued in the wrong name could not only delay revenue receipt but also result in nonrecoverable VAT.

The penalties for incorrect invoicing can be a percentage of the turnover, so amounts can quickly become material—up to 25 percent VAT in Europe (Hungary 27%) on the turnover plus penalties.

Intangible assets

One of the fundamental questions to answer is where the ownership of intangible assets will sit in the new structure and whether it will be migrated to a low-tax jurisdiction.

We have seen VAT charged on the sale of intangible assets from one U.S. corporation to another because the assets were exploited in Europe and the acquiring company had not planned ahead to assure proper registrations were in place.

In one case, VAT was not recoverable and the company incurred an unexpected cost to the transaction of about 20 percent of the value of the intangible asset. This is a prime example of relying on due diligence from a historical perspective.

If intangibles were not an issue before, the historical risk would not show up but the current and future risk would loom large.

Look in the ‘I’s

As anyone who has lived through the M&A experience knows, there are a number of moving parts relative to indirect tax. It is not uncommon for some things to be overlooked or underplanned. But when that happens, serious and material consequences can occur, substantially affecting the cost as well as the ultimate success of the transaction.

Once a commercial and tax-efficient structure is determined—one that addresses both historical and potential risk—it is time to take the theory behind the structure into the realm of practice.
Who is taking care of filing VAT registrations?

When should you apply for VAT registration, since average lead times in jurisdictions can be several months?

Who is responsible for maintaining a structure and making sure the business is acting in accordance with the model?

How is this communicated throughout the organization?

How will ongoing monitoring be handled?

Most ERP systems, including SAP, Oracle, JD Edwards, and Peoplesoft, are equipped with some form or forms of VAT functionality. However, they typically still require significant configuration and may need to be customized to deal properly with indirect taxes.

_They will also need to be updated and tested to reflect new contracts and billing flows._

Ownership of these tasks must be determined and communicated up front, so that the ERP system can accurately issue invoices from day one.

**Integration**

The next stage involves integrating the legacy business into the new business if possible, or devising a hybrid model through which the two legacy systems run side by side.

Although a fully integrated system is more likely to yield greater economies of scale, tax knowledge continuity is critical to managing risks in either case.

The continuity includes others outside the tax arena—the logistics team who understands the physical shipments and flow of goods and would complete and submit customs declarations; the shared service center clerks who actually create the sales invoices; the IT team who manages data sharing between different systems.
Impact

The impact we are talking about here is largely concerned with potential problems and cautionary tales.

• What if VAT registration is not obtained on time?
• The ERP system is not tested or updated?
• There is no central ownership of key processes?
• Appropriate project team participants do not understand the material impact of indirect tax?

The results of these gaps in practical application can range from logistical problems (customs not allowing goods to clear in a country) to invoicing errors (invoices needing to be redone and cash collections delayed), from incorrect tax treatment on transactions to difficulties in VAT compliance that can result in payment and reporting errors and penalties.

Interim solutions and workarounds

When the new business model cannot be implemented into the purchaser’s own ERP system within a given time frame, the typical solution is to temporarily outsource the process to the seller through a temporary service agreement.

But such workarounds, however practical, can lead to new risks.

In an asset deal, for example, an ongoing relationship with the seller as part of the transition agreement could be seen as outsourcing VAT accounts payable/accounts receivable processes.

That in turn could trigger VAT compliance issues, difficulties in accessing data, questions around the quality of VAT controls, and blind reliance on an ERP set up with an outcome that could not be verified.
There are possible people issues as well. Although the vendor’s (seller’s) staff and systems are used to bridge the gap until the necessary resources, knowledge, systems, registrations, and authorizations are in place, the people doing the work have no real vested interest in the new model. In fact, they may even be losing their jobs because of the merger or acquisition.

**Invoicing in the interim**

In worst case scenarios, staff members may not feel responsible for the work they are doing. We have seen results that, if not costly and catastrophic, certainly undermine the functionality and credibility of the enterprise.

One of the most common side effects of an integration that cannot be fully realized surfaces in the realm of invoicing.

For example, large numbers of payable invoices are not correctly coded so VAT is not deductible. Or when the legacy system is only half integrated into the new model, incorrect sales invoices are issued, causing problems for customers, incorrect reporting of tax figures, and missed compliance obligations.

*Knowing who is legally obliged and practically able to issue invoices is critical in interim or transitional situations.*

Is the previous owner legally allowed to issue invoices? Whose VAT compliance issues are these and how can the new owner obtain and share information?

Can the new company continue billing its customers?

*Implementing a transitional arrangement—especially if it is unplanned—can be expensive, causing delays to the overall integration and setting practical, commercial risks into motion.*
An indirect tax and acquisition checklist

Indirect tax risks are prevalent throughout the entire M&A and integration process. Here are some of the leading practices, lessons learned, and perspectives to keep in mind so that they do not become stumbling blocks:

- Set up a project charter that will take effect as of the very first due diligence activities.
- Validate due diligence findings and define priorities.
- Make an indirect tax integration plan and ensure that the right sponsors provide buy-in.
- Map out the current state upon acquisition and identify key risk areas, opportunities, and people in the organization acquired.
- Jointly validate and refine the integration plan and develop a road map to success.
The Intersection of VAT and shared service centers

Take for example a Shared Service Center. In the past local country teams were handling VAT matters and its department who had been there for a long period of time, had access to talented staff, and were well trained and also employee turnover was low.

*Under a Finance transformation all of their responsibilities are often moved to a far away location and new process owners who do not know the company's historical background and employee turnover is high. The local staff are often made redundant.*

The world has changed and so has the way the world does business — some say irrevocably, whether for better or for worse. An arguable upside of the global credit crisis is that it has provided many companies with an added impetus to look for ways to improve processes, manage costs, increase functionality and customer satisfaction, eliminate redundancies and extract additional value.

One approach that is growing in popularity is the migration to a shared service center (SSC) model. About 27% of the respondents to a recent Ernst & Young survey of global executives indicated that they plan to increase their use of shared service centers over the next year for functions ranging from property management to customer service, from IT software and network management to HR and accounting.

As varied as the drivers for and uses of the SSC model may be, there is one common denominator that is too often missing from the strategic or planning elements of the shared service discussion — indirect tax. And although these tax considerations may not be among the issues that drive a shared service decision, tax can certainly give rise to some significant and costly challenges. That is particularly true of value added tax (VAT), which hits a number of disparate points within the enterprise as diverse as finance, procurement, IT or HR.

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*Article was co-written with Katie Downs. The views expressed herein are those of the authors.*
For multinational companies (MNC), these touch points can arise in a wide range of countries and taxing jurisdictions as well. As MNCs move more and more to the shared service model to meet their varied objectives, the responsibility for indirect taxes migrates with them, especially in the case of VAT and goods and service tax (GST). Also, complexity in managing these taxes increases exponentially when cross-border activities are involved, especially in today’s VAT environment, where all too often controls are external, processes are manual and procedures are not documented.

Historically, the activities around transactions giving rise to indirect taxes have been handled by in-country entities that are more familiar with local regulations and compliance requirements and accustomed to the rules and obligations for invoicing, liability, rates, accounting and reporting specific to each of the myriad jurisdictions.

• But what happens when VAT and GST functions are transferred to an offshore SSC in some faraway location?

• How complex will the operational requirements be when one SSC is dealing with countless transactions that originate in multiple countries and languages and fall under the auspices of a variety of cultures and authorities?

Getting ahead of possible problems at the planning stage before they arise in practice is one critical way to make sure that the company reaps the benefits intended from an SSC migration. VAT needs to move to the top of the priority list whether a new SSC is being designed or an existing one evaluated.

A look at the risks and rewards

Since cost savings is one of the most common reasons for an SSC, companies often go to what are considered low wage countries such as the Philippines, Hungary, Poland, India or the Ukraine.

An additional upside of these countries has been the availability of educated and multi-lingual talent. However, what is often missed in the business case, planning and execution is a full understanding of the processes and controls needed to effectively and efficiently manage indirect tax.
This knowledge gap can give rise to some important considerations:

**Inability to comply with local VAT rules** — Although the root cause will vary from one company and country to another, the risk is likely to arise because of the fundamental lack of resources with local knowledge, clear VAT policies and procedures, technology enablement and controls and metrics to facilitate and monitor compliance. In most cases, there is some combination of these causes.

**System incompatibility** — It isn’t uncommon to find that the ERP system or other available technologies do not support SSC staff as fully or effectively as required in making sound decisions related to VAT.

**Processes not clearly defined** — SSCs sometimes find themselves operating without clear descriptions or instructions as to how certain processes should function internally. That typically includes specific division of duties and defined responsibilities for every task and the person assigned to perform it, as well as the protocols for communicating with the tax office to receive updated information, escalate issues and solicit valuable feedback. The more pieces missing, the greater the risk.

Non-existent or inadequate processes and documentation — Since indirect tax guidance is not typically part of the SSC brief, SSC staff may not have access to VAT training, manuals or web-based technology to support their decisions and activities relative to VAT.

**Insufficient communications** — Staff may also be hampered by inadequate or unorganized communications between the SSC and other operational business units (e.g., IT, logistics, group tax department) within the organization, making it very difficult to identify and address any crossover issues relating to VAT.

Non-existent or inadequate compliance controls — An indirect tax control framework and key performance metrics that focus on relevant indirect tax risk must be in place to provide the stability and transparency required to both enable and sustain compliance. None of these “risk drivers” are insurmountable or prohibitively complex to overcome. That said, there are some equally significant VAT-specific rewards in migrating to a well-run and well-founded SSC:
Performance improvement — Companies have seen a reduction in both manual effort and error rates in VAT processes from automating VAT decisions in an ERP environment and (or) using technologies available on the market such as tax engines and certain web-based applications.

Better time management — More time is available to tax staff to set up and implement VAT strategy and planning. Since part of the VAT functionality is transferred to the SSC, problems can be anticipated at an earlier stage and action taken to pre-empt or solve them.

Process improvement — With the SSC doing a good portion of the “heavy lifting,” the organization has more time and resources to review, adjust, structure and optimize existing VAT processes. It may also lead to the development of a VAT team to operate as part of the overall international tax team.

Consistency and flexibility — An efficient and effective SSC/VAT relationship can provide the company with a consistent operating model as well as flexible organizational design to support growth, profitability and compliance. Once the company has evaluated the risks and rewards and conducted any other due diligence, the processes begin for identifying the VAT-critical functions, diagnosing the current state and designing the structure that will enable the effective migration of VAT to SSC.

Identify, diagnose and design — steps for getting an SSC that works

VAT should be considered in every aspect of the migration process, from concept through completion and beyond. Although we’ve identified the three mega-steps as identify, diagnose and design, these are not necessarily discrete elements that take place only once.

These same steps can — and should — be applied from time to time to an existing SSC to make sure that it is optimized and functioning as efficiently as possible and that it remains consistent with enterprise objectives in the event of changes in the business profile.
**Identify**

VAT-critical functions are among the most common transaction-handling processes to migrate to an SSC. That typically includes such functions as accounts payable, general accounting, intercompany settlements, travel and expenses, tax filing, customer billing and order entry.

This is essentially the time for defining the scope of the SSC – documenting the current VAT processes for the various local business units and determining what countries the SSC will support and the processes for which it will be responsible. Underpinning these decisions should be a realistic perspective on the available technologies and talent pool, coupled with reporting and metrics for measuring performance.

Another important element built into making these choices is identifying their impact and any changes they could have on current processes. Centralizing functions into an environment like a SSC entails a shift of responsibilities, which then requires establishing and documenting new protocols and new lines of communication. This early stage is the time for surfacing potential problems and identifying the time frame and approach for addressing them (e.g., further integration of ERP systems, tax engines, procedural guidance and controls).

The complexity of change that comes with implementing an SSC and its various support systems gives rise to some critical considerations, so the company must fully understand the degree of change that’s about to occur and communicate and manage it across the enterprise.

**Diagnose**

The goal is to make sure that the outsourced VAT processes and functions are transferred and continue operating as effectively and efficiently as possible.

That means determining whether the current processes operate satisfactorily as is or need to be improved, factoring in any potential or existing differences and taking into account the complexity of the existing processes and the variations between these processes in each of the business units to be supported by the SSC.
One of the potential actions that may be taken is optimizing the VAT functionality of the ERP system. For example, some systems and tax engines include the option of using a condition table or decision tree to determine the appropriate VAT action without human involvement.

*This virtual VAT manager establishes the VAT qualification for each transaction by allocating a tax code to yield a specific VAT result.*

It is essential that any process functioning or being drawn up to function will reflect such changes as new customers, flow of goods, legislation, etc. and then is entered into the system accurately and in good time.

The system also must include adequate controls to ensure that transactions not within the scope of the condition table/decision tree cannot be completed without the involvement of an internal or external VAT expert.

If different applications are used, integrating multiple ERP systems into one ERP system could be an option, so this is the time to diagnose the current conditions in light of the actions to be taken, their timing and feasibility.

Keep in mind that ERP implementation immediately prior to the SSC’s go-live date is not realistic. Systems changes involve various stakeholders, are time consuming and realistically take months to complete, so they should be considered as a medium- to long-term objective.

As you begin to diagnose the current state and future objectives of your SSC plans, some of the questions that can help you determine the impact of VAT prior to migration.

- Do we have sufficient insight into current VAT processes including all manual adjustments, workarounds and internal quality assurances processes?
- Are the processes specific and well-documented and are they adequate to the new environment?
- Do we understand the scope of personnel changes that may occur as we migrate to the SSC?
• Have we captured all the relevant knowledge from personnel who may decide to leave the organization?

• Are we retaining access to and information about existing manual processes and procedures and offline solutions?

• To what extent do current processes depend on local VAT expertise and technology? How much will be lost in the event of a transfer to SSC?

• To what extent are different processes required from one jurisdiction to another?

• Who has final responsibility for the VAT compliance process at present and who will own it upon transfer to the SSC model?

• Where are the essential process controls being carried out?

• How does the SSC model deal with local VAT risks in terms of internal communication and coordination?

**Design**

There are no standard solutions, just the central requirement that any solution be VAT-compliant. What the future SSC/VAT interface will look like will depend largely upon the complexity of the transactions to be handled and the type of technology and talent available.

If the SSC design will be based upon the organization’s existing ERP system, it’s essential to know from the outset how well its structure and functionality will support the completion of the VAT processes.

It’s equally important to know the extent that technology will be used for electronic invoicing, tax engines, tax reports and other VAT-specific processes and to make sure that they are in keeping with any local VAT rules and guidelines.

Fundamental to the ultimate design is whether there is an integrated ERP system in place or the VAT compliance process is based on different applications.
If the infrastructure comprises a combination of applications, this increases the chances of manual adjustments having to be made for consolidation or other purposes, which in turn leads to greater VAT risk because of the higher margin of errors.

If employees with limited knowledge of VAT end up being responsible for manipulating and entering data, this begs the central question of whether the data can be considered sound.

Following are more questions that can help refine the design of the VAT/SSC intersection for short-, medium- and long-term functionality:

• What kind of supervision is in place for SSC staff responsible for carrying out the relevant VAT processes?
• Is hard copy documentation available on how staff members should carry out VAT processes?
• Alternatively, is technology used to select tax codes and is assistance provided in the form of intranet/internet/tax engines?
• What duties and responsibilities for VAT processes are assigned to the different members of the SSC? The business units? IT, tax, finance or other departments? Have these duties and responsibilities been clearly defined and documented?
• Is everyone aware of the responsibilities in terms of monitoring, delegating duties and establishing efficient and effective communication lines between staff members with varying responsibilities?
• What does the internal control structure pertaining to these processes look like?
• Which controls have to or can be carried out at the SSC and which have to or can be carried out at local level?

A real world example

A multinational company based in France decided to centralize and transfer functions to Switzerland. Not only did they neglect to document the processes and thoroughly analyze the VAT impact, they also lost staff that was familiar with the functions.
As a result, the company also lost access to the historical data relating to the preparation of VAT returns and had employees that were unfamiliar with the methods for preparing the returns or making manual adjustments.

At the time the VAT audit was announced, major panic ensued and the SSC staff had to work around the clock to obtain more insight into the original processes and collect information for reconstructing the VAT returns.

The company was at risk for the full amount of the VAT and for penalties of up to 100% of the VAT owed. In short, the potential benefits of the SSC migration were largely overshadowed by the additional time and money that had to be spent for this emergency response and the disruption to orderly operations.

**Upfront agreement and alignment**

Underpinning all the activities that comprise identifying, diagnosing and designing the SSC’s treatment of VAT and GST is transparent communication and a well-defined service level agreement (SLA) that everyone involved understands and supports.

That must include the responsibilities both within and outside the SSC, the division of duties and the protocols for communicating, resolving and escalating issues. Before the processes are transferred over, each one should be thoroughly vetted to confirm:

- Overall efficiency and functionality
- Feasibility within the SSC model
- SSC resources required
- Impact on current state and ongoing processes
- Impact on ongoing processes
- Critical success factors and performance measurement
Rollouts should be reviewed holistically from a portfolio perspective in order to understand and effectively manage the demands upon corporate and SSC resources and the return on investment for each major initiative. Likewise, the VAT work stream should be integrated with contingent technology and finance projects.

This may prove challenging as a number of initiatives, particularly those that deal with systems development and technology enablers, are often not visible to the tax function — another point that underscores the need for transparency and upfront communications.

*Failure to align with initiatives that can intersect with VAT can result in a VAT design that is inefficient from a process perspective and not a “best fit” for the business.*

**Underrating VAT — some cautionary notes**

Global indirect taxes can amount to as much as 75% of the overall corporate tax burden, with VAT and sales/use tax outlays nearly 40% of total business tax expenditures — almost twice as much as corporate income tax. And the more taxing jurisdictions around the world focus on taking in VAT revenues, the more prevalent will be VAT audits.

For a company that underrates the impact of VAT and fails to factor in its implications throughout the SSC design, the financial consequences can be huge:

- An oil and gas company had to pay $2 million in VAT instead of getting the refund they expected in the same amount.
- A mining company was assessed $500 million in taxes and penalties because they lacked the proper documentation.
- A consumer products company missed out on a $20 million VAT refund.
- A Fortune 100 company saw its officials put in jail because of personal liability.

Granted, not all these outcomes arose from the shared service model, but they were a direct result of failing to properly handle VAT. When SSCs are vested with the responsibility for VAT, the potential for risk at this level follows.
Managing by design — last words and leading practices

The levers for performance improvement that must be addressed to comply with VAT also help to fully optimize shared services and enhance the sustainable value they deliver.

So with proper planning for an SSC that manages VAT appropriately and proactively, the pain of noncompliance can be replaced with the gain of a leading practice shared service model. And that means managing by design — looking at any process or transaction from end to end and factoring in all the requirements and controls essential to designing and optimizing a compliant VAT process.

It also means addressing the roles and responsibilities connected not only with the processes being moved to the SSC but also with those that are being left behind, fully and accurately capturing local and tribal knowledge about how things actually get done.

Companies that efficiently and effectively integrate VAT into their shared service model will have these leading practices in common:

- They know that VAT is far more than a simple “wash” as a consumption tax but needs to be proactively managed throughout the buy and sell end-to-end processes.

- They look at the upstream and downstream processes connected with any transaction that carries VAT and have a transparent end-to-end perspective into the controls and metrics for each.

- They leverage the capabilities of their ERP systems to automate VAT processing wherever possible, and design their solutions so the decision is made at the right time by the right resource.

- They know that an SSC is not the end result of a one-time initiative. Rather, it’s a vehicle for continuous improvement, with the built-in ability to flex with the changes in company, industry, marketplace, business and the global regulatory environment.

- They know that VAT is not an add-on to the SSC model, it’s a critical requirement that if proactively managed brings an additional slate of benefits to the SSC.
Change of a company's business model

Geographic footprint of a multinational

If the reason of a business model change is to optimize the company's effective tax rate (ETR), minimizing cash tax effects or cost reductions or realize efficiency overall, it is important that with regard to managing such change the indirect tax function is timely involved.

*Will using a classic principal structure in the new entity help keep maximum profits in low tax jurisdictions?*

Tax planning is benefited when the business model has as outcome that the profit drivers such as the 'value added functions' and 'risk', are assigned to a low-tax jurisdiction.

If so, one entity will own title to inventory throughout the various jurisdictions and the principal would require a VAT registration in each location where inventory is held. Indirect tax issues should be addressed upfront during the design phase for proper implementation and executing of indirect tax planning as any change has impact on current processes and controls and its effectiveness.

Manage the impact of business transactions

Business model change such as a centralized operating model result often in an increased number of transactions and indirect tax obligations across many jurisdictions. Operational changes have a tax consequence due to the change in transactional flows and the change in a company's assets, functions and risks profile.

Operational disruptions

The change of a business model can create not only VAT risks, but as well commercial risks such as logistics problems - customs not allowing goods to clear in a country - in getting goods into a country and delays and hold off of shipments resulting in disruption
of daily business to invoicing errors (invoices needing to be redone and cash collections delayed), from incorrect tax treatment on transactions to difficulties in VAT compliance that can result in payment and reporting errors and penalties.

A root cause of 'delays and hold off of shipments' was that the company forgot to register for VAT or procurement forgot to agree with supplier who was importing the goods.

It could therefore also impact the company's reputation as also customers, suppliers, external auditor, senior management, tax authorities and even shareholders could become stakeholders when it goes wrong.

Important is to ensure that the new operating model is not only implemented correctly from a corporate income tax perspective, but also ensures that business processes are indirect tax aligned realizing support of the business in the areas of compliance, finance & accounting, legal, IT systems and regulatory matters. That means teaming with these work streams is a critical condition for success during design.

Adapt to change in time

It is recommended that the impact of such changes of the company's supply chain and/or location of its tax functions are determined in time. This could result in new set-up of ERP system and invoicing, new contracts, pricing procedures, processes and controls. Critical success factors are:

• Senior management support for change: 'the tax model should be based on business case and not vice versa'

• Existence of a solid and compelling integrated business case for the structure

• Sound, structured and proven design and implementation process driven by rigorous Project Management

• Complete understanding of the facts, objectives, transaction flows, business process and legal structure

• Early focus on integration with IT systems and operations
• Early buy-in to the “transformation” by management and those groups affected ('Change Management')

• Allocation of adequate resources by the company to manage and implement the project

How to determine the impact of VAT prior to migration

Some questions that might help in the right direction:

• Do we have sufficient insight into current VAT processes including all manual adjustments, workarounds and internal quality assurances processes?

• Are the processes specific and well-documented and are they adequate to the new environment?

• Do we understand the scope of personnel changes that may occur as we migrate?

• Have we captured all the relevant knowledge from personnel who may decide to leave the organization?

• Are we retaining access to and information about existing manual processes and procedures and offline solutions?

• To what extent do current processes depend on local VAT expertise and technology? How much will be lost in the event of a change or transfer?

• To what extent are different processes required from one jurisdiction to another?

• Who has final responsibility for the VAT compliance process at present and who will own it upon transfer to the new model?

• Where are the essential process controls being carried out?

• How does the new model deal with local VAT risks in terms of internal communication and coordination?
Migration to new jurisdictions

From a Tax Control Framework perspective, for setting up risk based controls, the more unusual the transactions, the greater the tax risks.

Migration to a new jurisdiction will most likely involve dealing with VAT. For some migrating corporations it may mean having to deal with VAT for the first time although probably for most, VAT will be a familiar concept with some variations from the ‘old’ jurisdiction.

Assessing the VAT treatment of the migration itself and the subsequent activities in the new jurisdiction is a necessary work stream that should run parallel with other disciplines, primary because VAT is a transaction tax affecting both costs and revenue, and there will invariably be many transactions happening to achieve the migration and the ongoing activities.

Disruption of daily business

Misunderstanding or not recognizing the VAT implications of the migration and subsequent activities in the new jurisdiction could result in an unwelcome and unexpected cost. However, the change of a business model cannot only create VAT risks, but as well commercial risks such as logistics problems in getting goods into a country and delays and hold off of shipments resulting in disruption of daily business.

A number of issues are addressed that should be considered for VAT purposes in order to ensure that the migration will take place in the most effective manner from a VAT perspective.

It is very much a question of assessing the VAT position of the entities affected by the migration as it is currently and determining whether the future position will be better, neutral or negative. If it is the latter, determine whether and how the VAT cost may be reduced.
VAT status of the entity migrating

Assessing the VAT status of the entity or entities migrating to the new jurisdiction is the starting point as that will give us a good indication as to whether the migration itself and the subsequent activity in the new location will be VAT neutral, beneficial to the current position or result in a VAT cost.

Avoid VAT costs

The process to assess the VAT status of the migrating entity or entities is to review the current treatment of its activities from a VAT perspective. If it is a pure holding company i.e., its activities are purely passive, its activities (certainly from a European VAT perspective) will be outside the scope of VAT with the result that it will be able to register for VAT.

VAT that it incurs on its costs will be an additional cost as such holding company will not be able to deduct that VAT. That hits bottom line. It is essential that from a VAT perspective, the VAT consequences of the method of migration is determined on time.

Why?

In practice - depending on the company's flexibility of course - VAT entrepreneurship might be achieved via restructuring to avoid or limit such a VAT burden. This is, however, only possible if VAT planning is considered at the right time, as correcting status retroactively does not work.

One other area for particular attention is to plan how external fees are purchased i.e. which legal entity should enter into the engagement with the different vendors. This is an area of contention with the VAT authorities over for example the VAT deduction on these costs.

The method of migration can be undertaken in a variety of ways. Thus, from a VAT perspective, the VAT consequences of the method of migration need to be determined to assess whether or not VAT incurred on the costs associated with the migration will be real cost or just a cash flow cost.
This will mean looking at the project plan to ensure that such steps are carried out in the most VAT effective manner, subject to commercial and other factors. Certain means of achieving the migration may enable advantage to be taken of particular VAT reliefs e.g. many countries allow a VAT relief of the transfer of a business as a going concern.

- How is the tax function involved in the legal structure and transactions?
- How is the tax function involved in operational changes in ERP implementation and cost reduction?
- Who is taking care of filing of the VAT registration?
- When should you apply for VAT registrations, since average lead times in jurisdictions can be several months?

The migration will result in that ERP systems have to be updated and tested to reflect new contracts and billing flows. Ownership of these tasks must be determined and communicated upfront, so that the ERP system can accurately issue invoices from day one.

People might also have left the company due to the migration and historical VAT knowledge - such as knowhow about the practical workarounds - might get lost. This becomes often in practice visible during a tax audit a couple of years later and questions raised by the authorities are then not easy, if at all, to answer.

**Processes and controls, roles and responsibilities**

- What are the VAT processes and controls going to be for the migrating entity?
- Who owns these controls?
- Will the tax knowledge of the migrating business be recruited, outsourced or considered a responsibility of central tax function?
- What technology will be purchased or reused?
From concept through completion and beyond

It is all managing change by design - looking at every process and transaction from start to finish and factoring in all the requirements and controls, essential to designing and optimizing a compliant VAT process. VAT should be considered in every aspect of the migration process, from concept through completion and beyond.

*Managing by design — looking at any process or transaction from end to end and factoring in all the requirements and controls essential to designing and optimizing a compliant VAT process.*
Zero measurement methods

When high risk indirect tax areas and lowest performing VAT processes - that have a direct impact on the company’s VAT objectives - have been identified, the next step is to measure the performance in term of effectiveness and efficiency of each of these processes.

"Measure the magnitude of that problem, determine why the problem exists, and generate a set of solutions to ensure that the problem goes away."

The first phase is however a zero measurement that identifies key indirect tax risks and worst performing processes that in the end should be improved. Verify indirect tax performance could be done via:

- VAT throughput
- Statistical sampling
- Data analysis
- ERP review

VAT throughput

It starts with the people in the organization becoming aware of the amounts that are at stake and the risks of something going wrong.

Big4 surveys show unanimously that we’re easily talking about amounts of 5 billion euros concerning indirect tax. Benchmark studies repeatedly create the same picture: too little control, too few KPIs and when a mistake is made in the control, it usually concerns large amounts of money.
A mistake of one percent can make the difference between profit and loss for a multinational company. Explain that to your shareholders.

What are the monthly respectively quarterly VAT/GST working capital requirements and if possible the amount of input tax leakage. Minimization of cash savings, interest and penalties, tax expense and audit assessments and maximization of attainable recoveries fit the own KPIs of senior management.

Indirect tax has often a low priority and that the focus of senior management is primary on direct tax effectiveness. To change this mindset as starting point the VAT throughput - amount of VAT under management - could be calculated via the company’s annual report and subsequently internally communicated as follows:

<table>
<thead>
<tr>
<th>Steps</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Take regional revenues from annual account or 10K</td>
</tr>
<tr>
<td>2</td>
<td>Multiply with average VAT</td>
</tr>
<tr>
<td>3</td>
<td>Enter costs of sales and selling, general and administrative expenses</td>
</tr>
<tr>
<td>4</td>
<td>Take out employee costs</td>
</tr>
<tr>
<td>5</td>
<td>Allocate to each region / country</td>
</tr>
<tr>
<td>6</td>
<td>Multiply with average VAT</td>
</tr>
<tr>
<td>7</td>
<td>Ad % for intercompany transactions (e.g. 30%)</td>
</tr>
<tr>
<td>8</td>
<td>Estimate total amount of VAT under management</td>
</tr>
</tbody>
</table>

Based on above exercise a summary can be drafted with the following output:

- Show that a 1% adjustment is material and impacts a company's shareholders value.
- Calculate VAT under management per share
- 1% error of VAT under management per share
- Earnings per share (EPS)
Earnings per share serves as an indicator of a company’s profitability: (net income – dividend on preferred stock) / average outstanding shares.

**Statistical sampling**

Sampling is the process of taking only a proportion of the total population of available data, when measuring the entire population would either be too expensive or take too much time. To ensure that sampling is done correctly, the sample must be representative of the larger population and be taken randomly. A random sample ensures that any one sample has an equal likelihood of being taken.

*While direct tax rates are decreasing everywhere across the world, the rates for indirect tax keep rising.*

An average multinational company has amounts of over five billion euros of indirect tax flowing through the books. A small error of one percent can make the difference between profit and loss, and thus poses a material risk at a due diligence investigation, in the event of an acquisition.

The Big4 audit organizations report in their indirect tax surveys on the increasing risks of additional tax assessments, substantial penalties and loss of reputation, as the amounts of indirect tax keep rising and KPIs and controls of indirect tax are lacking. Extremely large amounts of money without appropriate control are at stake.
The internal indirect tax function within companies – if present at all – is typically unstaffed and is no budget is available to effectively manage the indirect tax position globally.

* A due diligence investigation not only serves the purpose of mapping the material risks, but quantification of these risks is also essential. *

A traditional due diligence investigation normally involves completion of standard questionnaires and retrieval of standard information, which is provided by the vendor via a specially designed data room. When possible incorrect VAT determination is detected, a rough estimation of the magnitude of the VAT risks is made on the basis of turnover and sales figures.

This is not ideal for both vendor and purchaser, as it concerns much guesswork and thus usually provides an insufficient framework in price negotiations.

* The question is whether there is a method of determining the exact additional tax assessment in an efficient and effective way. *

It should first be noted that the starting point is always the identification and recognition of material indirect tax risks.

Every industry has its own specific risks and further differentiation is necessary due to the complexity of the implemented business model, and the risks arising therefrom with respect to indirect tax. Roughly speaking, the largest VAT risks in the following areas are:

- Cross-border transactions: legitimate application of the 0% rate
- Intercompany transactions: correct application of the VAT determination in the chain
- Input VAT: justified input VAT deduction
In order to quickly gain insight into the level of tax risks (i.e. calculation of the potential assessment), statistical sampling can be used. By selecting a few elements (euros), the reliability of the composition of tax items can be determined to a high degree of certainty, and on the basis of identified errors in the sample, the exact amount of additional tax assessment can be calculated.

The strength of this method lies in the fact that statistical sampling is the tax audit method used by the Dutch Tax Authorities. Calculation is done on the basis of the parameters that the Tax Authorities apply themselves in their tax audit.

Statistical sampling requires a different approach and process of information retrieval compared to the traditional method. In practice, this means the following steps are to be taken:

- Defining the scope (see aforementioned main VAT risks);
- Defining the sample size based on parameters of the Dutch Tax Authorities;
- Obtaining the data file provided by the vendor on the basis of instructions;
- Drawing the sample;
- Obtaining the selected (physical) invoices, claims, documentary evidence or other documents provided by the vendor on the basis of instructions;
- Fiscal assessment of the tax items;
- Calculating the amount of potential additional tax assessment on the basis of detected errors.

<table>
<thead>
<tr>
<th>Sampling</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sampling is the process of taking only a proportion of the total population of available data, when measuring the entire population would either be too expensive or take too much time.</td>
<td></td>
</tr>
<tr>
<td>To ensure that sampling is done correctly, the sample must be representative of the larger population and be taken randomly.</td>
<td></td>
</tr>
<tr>
<td>A random sample ensures that any one sample has an equal likelihood of being taken.</td>
<td></td>
</tr>
</tbody>
</table>
Who can benefit

Defining the scope and correctly designing and drawing the sample requires a multidisciplinary approach. In addition to knowledge on indirect tax, expertise in statistical sampling is required.

A sample is not solely relevant for due diligence of the purchaser. Also the selling party can benefit from sampling with regard to preparatory work for a prospective takeover.

When a statistical sample is drawn and the results are acceptable, the conclusions can be proactively taken into a data room. This can serve as extra evidence of implementation and maintenance of an effective control framework.

Moreover, in the Netherlands the possibility exits to align the results of the findings with the Tax Authorities, which provides more certainty regarding the adopted tax position. All this can positively contribute to the sales negotiations, including the amount of guarantees and/or discounts that are to be provided.

A good start is half the battle, and can lead to significant cost reductions in the future. Note this method can also be used for internal control.

Data analysis for VAT

VAT decisions are more and more shifting from employees who make entries in the system manually to ultimately the ERP system based on implementation of conditions tables/defaults.

Data analysis can be a way of testing whether these VAT decisions are logical.

The results of the data analysis can provide insight into the existing compliance risks or opportunities with respect to the remittance of too much or too little VAT.
In making VAT decisions, companies are entirely dependent on the underlying ERP system of the employees who manually process data in the system.

Data analysis can be used to check whether these decisions are legitimate. Such analyses can comprise all transactions in a specific period – year, quarter or month.

Data analytics can contribute to improving business performance:

- Cost reduction: by identifying potential cost savings and limiting expenses (for instance by tracing VAT that was erroneously not deducted)
- Risk analysis: tracing incorrect VAT determination or reporting incorrect returns
- Compliance: by identifying possibilities to improve the quality and efficiency of internal control

**Business challenge**

Data analyses of various market players are generally standard analyses that are generated by a data dump from SAP.

Extracting data from a SAP environment is often not possible due to lack of the proper authorization.

Moreover, the extraction of data is limited to a specific number of document numbers per extraction. This requires the same extraction to be executed over 30 times when an extensive amount of data is to be retrieved.

Retrieving data in multiple steps brings the risk of the format of the data not always being identical. As a result, there are no unequivocal results available and many manual adjustments are necessary. In the case of extensive data, SAP often breaks off the analysis, because run time limits are exceeded. In addition, due to restriction of the size of reports in SAP, created data files cannot always be copied to a pc.

_Solely standard analyses are possible, which does not sufficiently take into account the complexity of business models and specific risk domains._
Best practice data analytics

The risk domains should be salient. Knowledge for enabling fully automated VAT determination and building an integrated Tax Control Framework is crucial in data selection. Besides that it is important that only VAT relevant data is retrieved that is necessary for this analysis.

Providers of data analysis use for example third party software tools, so the data can be extracted from SAP in a uniform manner (data warehouses / centralized data hubs). For example, aggregate transactional data across ERP systems in use and connect automatically with as outcome that the blueprint of the company can be shown real-time.

*With this, problems regarding performance, format of reports and interpretation of data could belong to the past and guarantees the quality and integrity of data.*

'Turn data into information and information into insight'

This enables foreseeing future risks long before they manifest themselves. Use data-based insights for decision making. By linking your business strategy to advance analytical possibilities, decision-making capabilities can be improved.

* A business change can be simulated via 'what if' with real-time data and its impact can be quantified (data-based insights).*

Beyond indirect tax this should improve processes for management of e.g. transfer pricing, for logistics and warehouse locations management, cash flow planning, etc. Enhance your performance to make smarter, faster decisions:

- Many stakeholders can benefit from this functionality; it is accessible real-time and it should improve both internal and external effective communication because you can ‘talk numbers’. It will contribute to buy-in from other departments and ease the writing of problem statements.
- In addition, it will support business cases with the aim to realize sponsorship for change and better management of the Executives own KPIs as real numbers have actually been used.
ERP VAT review

A SAP review should highlight where the VAT configuration could be improved or if additional control measures should be added to the business’s Tax Control Framework.

Such review can also identify where errors occur and there are increased risks allowing a more focused data analysis to take place. After the quantification and evaluation of the risks and errors, these are assigned a risk profile for further testing of risk tolerance.

*During a SAP review for VAT and GST the proper working of the implemented VAT configuration has to be vericated.*

This will provide understanding of how changes in the business model, master data or legislation will have an impact on the implemented VAT configuration.

<table>
<thead>
<tr>
<th>Overview of known SAP errors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ineffective use of the proper partner functions in SAP for a supplier who provides services in multiple countries and invoices VAT locally. This can result in the standard VAT calculation generating incorrect results.</td>
</tr>
<tr>
<td>Incorrect derivation of VAT registration numbers for cross-border transactions caused by incorrect SAP configuration.</td>
</tr>
<tr>
<td>Missing/improper VAT registration numbers in customer master data, such that invoicing requirements are not satisfied for cross-border transactions.</td>
</tr>
<tr>
<td>Master data is adjusted and tested in the test environment, but the changes are not reflected in the production system.</td>
</tr>
<tr>
<td>The logic of the tax code structure is disrupted by VAT rate changes. This can be mitigated using the correct SAP configuration.</td>
</tr>
<tr>
<td>When performing reverse charge bookings, VAT rate changes do not get changed. For cross-border A-B-C transactions, a VAT mismatch between the VAT on procurement and the VAT on sales arises for party B.</td>
</tr>
<tr>
<td>Blocked iDocs (electronic interface documents) because of errors in the OBCD design.</td>
</tr>
<tr>
<td>Suppliers with invoices in other currencies and the VAT amount shown in Euro. This results in an incorrect VAT amount due to an incorrect FX conversion.</td>
</tr>
</tbody>
</table>
The deliverable should highlight where the VAT configuration could be improved or if additional control measures should be added to the business’s Tax Control Framework.

Therefore proper working of the implemented SAP VAT configuration, identify where errors irregularities occur or opportunities exist in the company’s SAP set up should be checked:

<table>
<thead>
<tr>
<th>VAT numbers</th>
<th>Tax code structure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign VAT registrations</td>
<td>EU code set up</td>
</tr>
<tr>
<td>Plants abroad</td>
<td>Tax tolerance</td>
</tr>
<tr>
<td>Tax procedures</td>
<td>GL accounts for tax</td>
</tr>
<tr>
<td>Intercompany/iDoc</td>
<td>Deferred VAT</td>
</tr>
<tr>
<td>VAT registration number selection for customers</td>
<td>VAT condition records</td>
</tr>
</tbody>
</table>
VAT determination of incoming invoices

The purchase order (PO) and the vendor invoice are the VAT relevant data sources used to determine the VAT treatment of incoming invoices. However, the vendor invoice data is in general not available in SAP. In order to automate the VAT determination, it is essential that external information is added in an easy and intelligent way.

In practice, many of the incoming invoices are still processed manually. AP clerks, who are not VAT experts, have to select the correct tax codes and thus determine the VAT treatment and reporting.

In order to manage this process, detective controls should be implemented to check whether this is done correctly. This is labor-intensive and poses a major area for VAT errors, such as failing to deduct the correct input VAT in the VAT return. It will therefore be an area of investigation during a tax audit.

<table>
<thead>
<tr>
<th>Audit Type</th>
<th>Risk Management</th>
<th>Risk description</th>
<th>Impact and likelihood: complexity and change</th>
</tr>
</thead>
<tbody>
<tr>
<td>AP</td>
<td>Invoicing</td>
<td>• Lack of proper knowledge or effective processes and controls to determine correctly the VAT treatment of AP invoices.</td>
<td>In scope given the materiality (sum of taxes deducted each period) and inherent risk based on complexity and change is high when outsourcing of VAT functionality applies with VAT AP processing and procurement.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Lack of effort and/or commitment to remediate and improve processes</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>• Ensuring that unacceptable indirect tax risks will be prevented</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Ensuring that unacceptable indirect tax risks will be identified</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Ensuring that identified indirect tax risks will be managed and mitigated</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Repetitional risks</td>
<td>Important vendors are not paid in time that might disrupt the business</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Strategic risks</td>
<td>Failure to drive the optimum relationship with the (indirect) Tax Authorities</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Operational risks</td>
<td>Failure to identify relevant changes in VAT legislation and communicate in time at all to the Purchase Order/Accounts Payable departments</td>
<td></td>
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<tr>
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<td>Compliance and Financial risks</td>
<td>Failure to perform VAT impact analysis review/s with respect to business strategy changes</td>
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<td>VAT changes of the supply chain are not communicated in time to the Purchase Order/Accounts Payable departments</td>
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Richard H. Cornelisse
Business challenge: understand process errors

When an incorrect VAT result is caused by the incorrect data in the PO, the remediation takes place via updating the PO with correct data and re-processing the related transactions (goods receipt, etc).

Such a process causes workforce inefficiencies due to the hidden factory. Definition of ‘hidden factory’ or ‘hidden operation’: the rework and cover-ups, the hours and days of wasted time in a company of people who constantly correct mistakes (unnecessary rework).

The objective is to make the hidden factory visible (measure/calculate ROI) and as a result, return precious time and money to the business.

The AP clerk often fully relies on the purchase order and is unaware that this purchase order might no longer reflect the actual situation. For example, if the vendor decided to execute the transaction differently from what had been initially agreed upon – the vendor decides to deliver from another country as locally the goods were not in stock. That causes a gap between data in SAP and the formal invoice (i.e. incorrect use of goods supplier partner function). That gap has to be closed.

Additional complexity arises when the purchase orders relate to services and not to materials or when the VAT is not fully deductible.
Incorrect VAT numbers

A prerequisite for the application of the 0% rate for cross-border transactions within the European Union is a valid VAT number of the client. The valid VAT number must also be mentioned on the invoice. Adequate monitoring of this is crucial to eliminating risks as much as possible.

It is possible to check the syntax – the format of the VAT number, including the number of positions. However, it is not possible to check whether the VAT number is valid. To this end, the European Commission has provided an online database, VAT Information Exchange System (VIES) for the validation of VAT numbers.

We check 'the VAT numbers' during our data analysis exercises. In practice, it appeared that between 5 to 25 percent of the existing VAT numbers in the customers and/or vendor master data were incorrect or invalid.

From a VAT perspective, this is a material tax risk area as the 0% VAT rate might have incorrectly been applied and the risk amount involved would most likely exceed the company’s risk appetite. This especially applies when cross-border transactions are part of normal course of business. It will therefore be an area of investigation during a tax audit.

An important control measure in terms of material indirect tax risks is checking whether the 0% rate is correctly being applied.

The number of erroneous VAT numbers were close to 25% in that particular case. From a VAT perspective this implies material risks that exceed every risk tolerance.

Financial impact

If not correct, the tax authorities might seek to recover tax due from this supplier via a levy of a tax assessment. If the applicable VAT rate is 25%, the tax assessment will be 25/125 of the consideration charged. This assessment will be increased with interest and penalties to determine the total tax burden.
The outcome of a valid and correct VAT numbers assessment can be used as supportive arguments for writing a problem statement and business case.

VAT numbers can expire or change due to changes in the legal structure of customers. It is therefore, again, important to periodically check the validity of the VAT numbers.
ERP systems and tax engines

Most ERP systems, including SAP, Oracle, JD Edwards, and Peoplesoft, are equipped with some form or forms of VAT functionality. However, they typically still require significant configuration and may need to be customized to deal properly with VAT.

ERP systems also need maintenance and have to be updated and tested to reflect new contracts and billing flows. Ownership of these tasks must be determined and communicated upfront, so that the ERP system can accurately issue invoices from day one.

One of the potential actions that may be taken is optimizing the VAT functionality of the ERP system. For example, some systems and tax engines include the option of using a condition table or decision tree to determine the appropriate VAT action without human involvement. This virtual VAT manager establishes the VAT qualification for each transaction by allocating a tax code to yield a specific VAT result.

It is essential that any process functioning or being drawn up to function will reflect such changes as new customers, flow of goods, legislation, etc. and then is entered into the system accurately and in good time. Adequate VAT controls have to be implemented to ensure that transactions not within the scope of the condition table / decision tree cannot be completed without the involvement of an internal or external VAT expert.

Systems changes involve various stakeholders, are time consuming and realistically take months to complete, so they should be considered as a medium- to long-term objective. That means action has to be taken in time to avoid that substantial work is done outside ERP in for example Excel.

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In the last decade, companies have increasingly automated their business processes. The most common method is by using an Enterprise Resource Planning (ERP) system.

Such a set up can be hugely complex. This is definitely the case where it relates to European based indirect tax.

As manual processes are subject to human error, automation could - under circumstances - result in performance improvements and savings.

A third party tax engine is considered sometimes a better solution than improving the indirect tax functionality of its own ERP systems. That often applies when the organization uses multiple ERP systems. Interfacing via a bolt-on could be an alternative.

ERP systems such as SAP and Oracle either determine the VAT treatment (liability and VAT recovery) of businesses’ transactions automatically or this is a (semi) manual process.

Multinationals run often various versions of ERP systems or legacy systems without harmonization. The ERP set-up is often per business unit and thus multiple set ups per country are possible.

This could be the root cause that:

- Running of system’s exception reports to look for missed opportunities, under claimed VAT and potential fraudulent transactions is still a challenging exercise
- A lot of manual (re)work is often needed to file the VAT reporting and reconcile the VAT numbers due to the use of multiple spreadsheets and various data sources (divisions, different systems)

The latter is interesting as spreadsheets are usually found at critical points in the audit trail and often designed by non-specialists with no system expertise.
More than 80% of businesses are still using spreadsheets to manage their VAT compliance in at least one jurisdiction in which they operate, despite tax authorities around the world investing in better tools. - *Eight out of ten businesses still using spreadsheets for VAT compliance* | *International Tax Review*

**Some objectives to consider**

- Indirect tax department utilizes leading edge tools and technologies in an integrated manner fully leveraging functionality offered
- ERP and other systems are tax enabled and tax sentient at the transaction level to support compliance, financial reporting and tax planning.
- There is dedicated IT support for indirect tax
- Spreadsheets are replaced by technology tools and systems
When is standard SAP (in)sufficient?

Technology is a facilitator for optimizing processes. In order to determine areas of improvements in current processes, the starting point is a good understanding of weaknesses (i.e. limitations) of SAP, insight into the current processes of a company, current SAP set-up and the company’s operational business model.

If full ‘VAT automation of Accounts Receivable (AR) and Accounts Payable (AP)’ and ‘being in control’ are important objectives of your organization, it is important to understand what exactly makes Standard SAP not functioning optimal from an indirect tax perspective.

Only then it is possible to validate whether a company’s objectives can be achieved via upgrading Standard SAP functionality and/or implementing an external tax engine.

When is Standard SAP sufficient?

Standard SAP itself is only processing a transaction within one specific company code and the consequence is that standard SAP VAT determination logic and functionality for VAT determination should therefore only work for:

- AB scenarios
- Cross border intercompany
- AB scenarios: electronic invoices via EDI/iDoc
- Local ABC scenarios (e.g all legs in France)
- ABC scenario with a static business model (for instance leg B-C triggers always the same VAT treatment)
Any standard SAP gaps could be resolved with limited adjustments the overall VAT determination improved via standard design of VAT condition tables, access sequences, tax codes, tax sensitive master data, configuration of customer VAT registration number.

**When is additional VAT functionality required?**

The SAP VAT determination logic was developed a long time ago (1980s) and except for the “plants abroad” logic, SAP’s VAT determination logic has not changed much. This stands in contrast with the VAT rules and business models as these have changed significantly.

The VAT landscape and rules have gone from fairly simple to rather complex. Cross-border transactions changed from solely export to a new category within the EU: Intra community transactions (goods and services) with distinct rules and new formalities to manage.

New business models have resulted in an increase of intercompany transactions, the use of chain transactions, drop shipments and pick up transactions. These are causing IT bottlenecks to implement as Standard SAP VAT determination logic and functionality do not work for these complex dynamic business models.

The root cause is that both Standard SAP and bolt-on tax engines exclusively focus on transactions within a single company; it only assesses the underlying individual transactions and fails to link the current transactions to the VAT results of previous transactions.

When more than 2 parties are involved, the VAT treatment depends on the VAT treatment of the prior transactions:

- **ABC (D) transactions** involving supplies of goods and which are transported to another Member State or Member States. In that case it is important to identify in which part of the chain the intra-EC supply and local supply or supplies take place (‘Cross border drop shipments’)

Richard H. Cornelisse
• ABC transactions involving 3 parties in the supply-chain, which are identified for VAT purposes in three different EU countries, and for which the goods are transported directly from EU country A to EU country C. Under certain additional country specific requirements (not harmonized amongst the EU member states) such a transaction may qualify as triangulation, so that the respective “simplified triangulation rule” would be applicable.

• ABC (D) transactions involving a supply of goods which are exported to a place outside the EU. In this case, it is important to identify in which part of the chain the export takes place in order to determine the impact on the VAT qualification of the other parties in the chain transaction (Import / Export transactions ABC transactions).

• ABC (D) transactions involving a supply of goods which are imported to a place inside the EU. Again, it is important to identify in which part of the chain the export takes place in order to determine the impact on the VAT qualification of the other parties in the chain transaction (Import / Export transactions ABC transactions).

When we take the first bullet as an example of the complexity, one could think of the possibility that the invoice flow and physical flow of goods have a mismatch. That could be the case if party B request party A to deliver the goods directly to party C in another Member State (i.e. drop shipments).

Standard SAP will determine the VAT qualification based on the ‘ship-from’, ‘ship-to’, ‘material’ and ‘customer tax classification’ information in SAP. It will for instance not take into consideration the multiple VAT registrations from party B. That would mean that not only the transaction A-B but also B-C cannot be derived correctly.

From a legal perspective only one transaction can qualify as a zero rated intra-EC supply. In such ABC cases, one of the 2 transactions should be charged with local VAT.

An exception exists - second bullet above - when the supply chain fulfills all requirements of the simplified triangular. Under these strict conditions both transactions could be zero VAT rated.
Financial impact

The supplier is responsible for ensuring that all the conditions for applying the zero VAT rate are met. If not, the tax authorities will seek to recover tax due from this supplier via a levy of a tax assessment.

*If the applicable VAT rate is 25%, the tax assessment will be 25/125 of the consideration charged.*

This assessment has to be increased with interest and penalties to determine the total tax burden.

Without adjustment of Standard SAP setting, an incorrect VAT treatment would be determined causing non compliance risks.

Patch-up solutions

One approach is to work with assumptions and to implement these in the system resulting in predefined VAT treatment (hard coding). An example is the assumption that the company is always buying with local VAT in the vendor country and therefore always sells using the VAT number of this vendor country.

This means that a VAT treatment is no longer determined based on actual transactional data in SAP. Assumptions may be implemented incorrectly or may change after go-live. This might result in an incorrect VAT treatment with potential compliance and/or financial risks.

If managing VAT risk is the company's policy, periodic VAT audits as detective control need to be set up since the risks at hand will likely exceed the company's risk tolerance.

This results in extra man-hours, additional costs due to rework (credit/debit notes) and retrospective corrections and/or disclosures.

*In order to fix a problem, we have to first understand the root cause thoroughly.*
We have to accept the possibility that the problem involves far more than what is immediately apparent and will require more work than is estimated at the beginning.

An important question to raise is what tools are available in the market that achieve full VAT automation without making use of assumptions and that determine the VAT treatment based on all real time VAT sensitive data in the SAP?

**Specific SAP VAT areas of attention**

**Triangulation**

Triangulation is used to describe a ABC chain transaction, which involves three different parties where the products are shipped directly by party A to party C. Party B acts as intermediary, never physically receiving the products.

A cross-border triangulation sale with three parties in three different EU countries has the following VAT consequences. Without any special rules party B would be considered to take legal title either in the EU country of dispatch of the products or in the EU country of arrival.

If party B is not VAT registered in these countries it will need to register for VAT purposes in one of these two EU countries.
Simplified triangulation

In order to apply the simplified triangulation measures, the following requirements are set by the EU VAT Directive:

- There must be 3 parties in the supply-chain, which are identified for VAT purposes in three different EU countries;
- Party B, must not be established in the EU country of arrival of the goods (EU country C) and in the EU country of dispatch (EU country A);
- The goods must be transported directly from EU country A to EU country C;
- Party C must be registered for VAT in the EU country where it receives the products (country C);
- The transportation of the goods must be ordered / arranged in the first part of the chain (i.e. between party A and party B).

The simplified triangulation rules do not apply if party B is registered for VAT in the EU country of dispatch and/or established in the EU country of arrival, however not all EU countries apply this rule strictly and there are in practice many country specific requirements.

Due to the country by country deviations of the standard rule there are many country specific rules for triangulation. That means that in the determination logic different local rules should be taken into consideration when Party B is VAT registered in either the Ship from country or the final Ship To country where the customer receives the goods.

If the supplier (i.e third party vendor) is not set up in SAP the ship from location will not be available in standard VAT determination during billing and sales.

Based on the above the consequence of the simplified triangular is that standard SAP often requires manual intervention. Staff (sales order staff/customer services representatives) needs to be trained to manually determine triangulations and detective controls have to be set up that it is done correctly.
This manual intervention could be avoided if extra functionality is added to standard SAP that recognizes these triangular scenarios and all the country specific rules so it can deal with it in an automated way.

**SAP and import, export and chain transactions**

**Specific considerations about export/import**

- Define the correct legal partner for VAT
- Determine the correct ship-to country
- Differentiate between export/import and out of scope

Below examples explain the difficulties from a VAT automation perspective as standard SAP operates on company level only

**Import scenario further explained**

A Dutch Sales organization is selling goods to a French customer. The goods are not in stock and are purchased from a Singapore group company. Transport is by vessel from Singapore to Rotterdam and then by truck to the French customer.
To determine the VAT treatment of the supply chain it is essential to know who the importer of records is. Is that the NL sales organization or the FR customer and where will the import takes place (country).

**From a VAT point of view the difference for the sales invoice is as follows**

**Importer of record = NL Sales organization in country NL**

- NL sales organization must invoice as an intra-community supply 0% from the Netherland to France to the French customer
- Transaction must be reported in Intrastat (dispatches) by NL sales organization
- Transaction must also be reported on the EC sales list

**Importer of record: Customer in France**

- NL sales organization must invoice as an out of scope 0% on the invoice to the French customer as the transaction takes place before any import in Europe
- There is no Intrastat obligation by NL sales organization

**SAP and 'Plants Abroad'**

The SAP 'Plants abroad' functionality is designed to handle tax issues for companies that have warehouses/distribution centres and VAT registration numbers in more than one EU country.

The functionality enables the use of different Tax reporting countries within one company code, the use of the correct company VAT registration number for the sales invoices, the correct VAT treatment for cross border stock transfers and consignment transactions and easier VAT and Intrastat reporting.

When should plants abroad be used:

- If a company has plant/storage/warehouse locations in multiple EU countries and the company is VAT registered in these plant/storage/warehouse location countries
• If there are intra-company transfers of goods between plant/storage/warehouse locations or in case of consignment stocks in multiple EU countries

• If the countries where the company is VAT registered are using different 'tax currencies'

When plants abroad is implemented a new field for tax reporting country and currency conversion is available for VAT reporting.

With activating plants abroad functionality you do not need to create separate company codes for European plants or implement manual processes for VAT and Intrastat reporting.

**Cross border stock transfers and plants abroad**

In below example an intracommunity acquisition of goods via reverse charge mechanism needs to be reported in the German VAT return and an intra-community dispatch in the French VAT return.

These transactions also needs to be reported in the Intrastat report.

With the plants abroad functionality a plants abroad invoice (document type WIA) for cross-Border (intra-company) stock transfer can be created between a foreign plant (e.g. warehouse in France) and a domestic plant (e.g. warehouse in Germany) as such transaction is deemed to be a fictitious intra community transaction from a VAT perspective.
The SAP impact of activating plants abroad

The 'Plants abroad' functionality is integrated in SD, MM and FI. By activating the functionality new fields are updated at transaction level. These new database fields for plants abroad are standard available in every SAP environment.

On the tax code properties a new field ‘Tax reporting country’ is added and the ‘Tax reporting country’ field is added on the VAT return reports and EC sales list. A new currency field will be added to enable conversion of the VAT relevant amounts to the tax country currency.

New processes for stock transfers (intra-company replenishment/consignment business) are supported and enable creating a self-invoice (the “WIA” process). Although 'Plants Abroad' is primarily global cross function setting in SAP it is possible to implement is only for specific company codes. From a VAT perspective the SAP risk of activating plants abroad is low.

Roadmap of activating plants abroad

- Review tax codes
- Update all relevant tax codes with ‘tax reporting country’
- Setup alternative currencies
- Update exchange rate type per country
- Setup configuration for stock transport orders including new pricing procedure
- Review tax code selection for Accounts Payable and Accounts Receivable as this might be impacted
Tax engines questions to ask before you commit

Determining the VAT liability and VAT recovery of businesses’ transactions (the system’s indirect tax functionality) can be automated within Enterprise Resource Planning (ERP) systems such as SAP and Oracle, or by way of a manual process. Multinationals often run various versions of ERP systems without harmonization. The ERP set-up is often per business unit and thus multiple kernels per country are more likely than not.

In the last decade, companies have increasingly automated their business processes. The most common method is by using such ERP system. Such a set up can be hugely complex. This is definitely the case where it relates to European based indirect tax.

As manual processes are subject to human error, automation could - under circumstances - result in performance improvements and savings. A third party tax engine might be a solution than improving the VAT functionality of its own ERP systems when the organization uses multiple ERP systems. Interfacing via a bolt-on could be an alternative.

In practice, configuration (the amount depends) is needed when companies deal cross border and/or complex business model are set up such as a centralized principal structures. This could cause difficulties in running exception reports to look for missed opportunities, underclaimed VAT and potential fraudulent transactions.

A lot of (manual) work is required when reconciling the periodic VAT compliance reports from these different sources (divisions, different systems). As the ERP systems do not have flexible reporting solutions, multiple spreadsheets are often used to reconcile VAT numbers. Manual processes are subject to human error and often inefficient due to the amount of rework (‘hidden factory’).

Hidden factory or hidden operation is defined as the rework and cover ups, the hours and days of wasted time in a company of people who constantly correct mistakes (unnecessary rework).

It is about extra man-hours, additional costs due to rework (credit/debit notes) and retrospective corrections and/or disclosures.
'Remediate own ERP system' or purchase a 'third party solution'

VAT functionality can be automated (full or to a certain extend) in a company’s ERP system. The problem might be that multiple ERP systems are used and that interfacing via a third party tax engine is considered an alternative. That option means that part of the system functionality is actually outsourced.

Essential as first step is that you actually know what tools are available in the market that achieve such VAT automation objectives? And that thus functionality increases workforce efficiency, avoids rework, decreases risk exposures, increases visibility and awareness by which the tax function is able to set better priorities.

Some important questions from a tax software selection to ask

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<th>Does remediation of own ERP systems close any gaps?</th>
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<tr>
<td>2</td>
<td>Is setting up a single ERP platform within the company a practical solution to consider?</td>
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<tr>
<td>3</td>
<td>Are third party solutions available to harmonize multiple ERP systems?</td>
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<tr>
<td>4</td>
<td>What is the advantage of third party solution compared to upgrade own ERP system(s) (GAP versus SWOT analysis: complexity of business model, number of tax codes needed now and in the future, resource requirements to manage the rules and VAT rates, monitoring and controls)?</td>
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<td>5</td>
<td>Is a third party solution required for determination and calculation of indirect tax or only for the reporting?</td>
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<td>6</td>
<td>What reporting functionality does my organization need?</td>
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<td>7</td>
<td>Are risks of outsourcing functionality known, documented and managed?</td>
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<tr>
<td>8</td>
<td>Are the liability clauses of the third party known and evaluated?</td>
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<tr>
<td>9</td>
<td>Is the financial position known of this third party?</td>
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<tr>
<td>10</td>
<td>Is the market position known of this third party (sustainability, competitor's strength)?</td>
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<td>11</td>
<td>What is the feedback of customers (references and credentials)?</td>
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<tr>
<td>12</td>
<td>What is the amount of staff of this third party?</td>
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</tbody>
</table>
| 13 | What is the company's history where it relates to upgrades its technology to trends in the tax market and client needs (amount of upgrades)?
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<tr>
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<th>Question</th>
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<tr>
<td>14</td>
<td>Is the solution compatible with existing ERP environment?</td>
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<tr>
<td>15</td>
<td>Is the IT architecture of the third party solution compatible with the existing IT landscape?</td>
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<tr>
<td>16</td>
<td>Is the interface of the solution “approved/supported” by the ERP system supplier (i.e. SAP Netweaver partner)?</td>
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<td>17</td>
<td>What will be the level of configuration / customization in ERP system and/or third party solution?</td>
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<td>18</td>
<td>How much time does it normally take to implement a country, region or even a big bang roll out?</td>
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<tr>
<td>19</td>
<td>Does the third party have an example of a roadmap for implementation that includes each others roles and responsibilities and milestones?</td>
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<tr>
<td>20</td>
<td>Which countries and indirect taxes are supported by the third party solution?</td>
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<tr>
<td>21</td>
<td>What is the impact on the company's own resources?</td>
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<td>22</td>
<td>What does the price tag look like (initial fee, configuration fee, license / usage fee, maintenance fee, etc.)?</td>
</tr>
<tr>
<td>23</td>
<td>What is the level of support a vendor gives in case of trouble shooting, legislative updates, irregular maintenance, etc.?</td>
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Roadmap for VAT introduction in GCC when operating SAP

The Governments of the Gulf Cooperation Council (GCC) - Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates that make up GCC - are committed to form a common framework for the introduction of value added tax (VAT) in the region.

In order to achieve conformity within the GCC, it is anticipated that the six member states will all aim for implementation of VAT during the period commencing 1 January 2018 or by the end of 2018.

VAT as a process will affect many aspects of businesses operating in the GCC and will require significant time to plan, and integrate into existing processes.

GCC Roadmap: implementation activities for SAP

**Implementation activities in SAP IMG for VAT:**

- Configure tax procedures for all relevant Gulf countries for VAT solution (Access sequences, Account Key/Condition, Country assignment)
- Create new required tax codes in SAP (transaction FXTP) for all relevant Gulf countries with required parameters
- Configure posting tax amounts based on created tax code for automated tax posting
- Create VAT condition records for all VAT relevant sales scenarios
- Define and update setting for VAT registration numbers
Implementation activities in SAP IMG for Excise Duty:

- To be defined based on the actual requirement: dependent on excise duty calculation/accounting based on sales quantity (comparable with VAT) or movement of goods

Activities related to pricing procedures/policy:

- Review all used pricing procedures
- Add required tax condition types to sales pricing procedures

Activities related to transaction output (billing documents):

Advise on changes to be made to print programs/output types: based on legal requirements:

- Invoice tax text messages (SO10)
- VAT registration number customer
- Tax rates and amounts

Documentation activities:

- Develop and draft documentation for the VAT solution in Gulf countries for SAP consultants (configuration documentation)
- Develop and draft documentation for the VAT solution in Gulf countries for business users including rate changes, implemented VAT logic and VAT reporting

Testing activities:

- Unit testing for VAT solution for all Gulf countries

Common framework

The Governments of the Gulf Cooperation Council (GCC) - Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates that make up GCC - are committed to form a common framework for the introduction of value added tax (VAT) in the region.
In order to achieve conformity within the GCC, it is anticipated that the six member states will all aim for implementation of VAT during the period commencing 1 January 2018 or by the end of 2018. VAT as a process will affect many aspects of Client’s business and will require significant time to plan, and integrate into existing Client's processes.

**Client's objectives**

- To be ready in time and a need of an effective and efficient work process between Tax function, IT function and its third party consultants
- To optimize its VAT deduction and to automate this VAT process as much as possible in SAP
- To limit VAT risks and meet VAT reporting obligations (e.g. reverse charge mechanism to avoid non VAT compliance)
- To automate VAT processes via enhancing the SAP 'as is' functionality where possible
- Set up processes and controls when VAT automation is not feasible
- To test new SAP functionality prior to go-live (sandbox)

Based on above objectives this document established the scope, schedule and means of initiating the work to be performed by the service provider and describes or references the specifications, instructions, standards, and other documents, which the service provider shall satisfy or adhere to in the performance of the work.

**General description of the work**

There are two distinct phases for the VAT system implementation, the Solution Design (PHASE 1) and the System Implementation (PHASE 2). This scope of works identifies in detail the requirements for PHASE 1 and PHASE 2.

The service provider will normally be assessed on their ability to perform both phases.

- **Phase 1** - Design a Business Blueprint outlining the implementation of VAT in SAP and supporting systems. Develop this blueprint through understanding and incorporating the GCC VAT law, Client's VAT strategy, detailed business requirements and current system landscape.
• **Phase 2** - Implement the blueprint in conjunction with the Client's IT team, including testing, training, documentation and go-live support. Develop the appropriate reporting for compliance with GCC VAT between Client's SAP system and government authorities.

**Phase 1: Design IT System Blueprint**

What is expected:

- Develop a complete understanding of the Client's VAT strategy, GCC VAT regulations and Client's current system landscape
  - Identify and assess the impact of Client's current system configurations, including SAP and any associated systems
- Review the process maps provided by Client
  - Identify the existing business processes that will be impacted by the introduction of VAT
  - Identify any processes that require further mapping
- Identify VAT touch points at both a process and system level that will need to be changed to facilitate the capture and accounting of VAT
- Consider how the VAT dependent SAP integrated systems should be configured and include within the design how this should be achieved
- Explore and identify the most efficient system design, to ensure the application and capture of VAT is complete, sustainable, effective and compliant into the future
  - The design should provide the most effective method of completing VAT calculations
  - Also ensuring that the design results in complete and compliant VAT reporting
- Incorporate within the system design the most effective method of VAT determination for recording Output VAT and Input VAT including imports, reverse charge and exports
• Evaluate the reporting requirements as defined within the GCC VAT regulations and ensure the system design enables these

• Document the changes required to be implemented at process and system level

The following activities are also expected from a Kick off, Diagnose and Design perspective:

**Kick-off**

• A kick-off via workshop(s) led by service provider

• Review the current SAP / systems setup via direct access to SAP

• Disclose with IT basic SAP VAT functionality needed to meet the VAT automation aim

• Get understanding of the current impact analysis of team, discuss gaps and actions

• Propose a project plan with key milestones and deadlines aligned with deliverables

**Diagnose**

• Understand the impact and conduct an impact analysis to fully understand the implications for the business:
  
  • Transaction mapping to label VAT taxable transactions
  
  • Assess the current sales, procurement and accounting processes
  
  • Review current SAP environment including interfaces when applicable

**Design**

• Design a VAT blueprint for final SAP VAT blueprint and /or new VAT processes and controls

• Workshop to present the SAP VAT recommendations and validate SAP VAT feasibility

• Design the final SAP VAT blueprint. Appendix contains a complete overview of the expected activities to be performed
• Design harmonized tax code structure for all GCC countries
• Design VAT processes and procedures (e.g. reverse charge mechanism to avoid non VAT compliance) for sales and procurement
• Design processes and procedures for a sound tax audit defense
• Workshops to validate and sign off of the final deliverables
• Design unit test and user acceptance test scenarios for testing in SAP development systems

Phase 2: System Implementation, Training and Documentation

System Implementation
• Work in conjunction with Client’s IT for implementation of the system blueprint in SAP and any supporting systems
• Facilitate user testing of reports produced from the system to ensure they are accurate, complete and effective to enable compliant return filing
• Facilitate, oversee and provide sign off for all User Acceptance Testing (UAT).

Training and Documentation
• Provide Configuration documentation for the implementation
• Provide Functional and Technical Specification for all developments done in the system
• Provide new standard operating procedure documents for business processes
• Assist with the communications and training plan for business users
• Assist with the communication plan with domestic suppliers in regard to catalogue pricing, invoice requirements and general VAT compliance
• Provide technical documentation of VAT specific procedures in SAP and related systems for the Client's IT department
• Provide user manuals and key user training to the Client's IT department
The following activities are also expected from a *Implementation* and *Testing* perspective:

**Implementation**

- Execute the SAP VAT blueprint and configure SAP for VAT in cooperation with IT staff in SAP development systems
- User training of new VAT procedures and controls (sales, procurement, accounting)
- Setup Governance structure and discuss with process owners appointed any new VAT procedures

**Testing**

- Develop test scenarios for user acceptance testing (UAT) and interface testing
- Validate VAT results for all test scenarios
- Test VAT processes and controls

**Criteria for evaluation**

- Experience with VAT introductions
- Experience with SAP VAT implementation
- Providing all the activities of PHASE 1 and PHASE 2
- Engagement team (quality, service provider’s proven ability to realize the objectives of such engagements, etc.)
- Price and pricing structure (EUR)
- Technology capabilities (functionality, added value, analytics) and flexibility to vary outputs/reports to meet Client’s needs
- Client references
SAP VAT building blocks

VAT actions for all systems

- Review basic VAT/Tax set-up in system
- Configure required tax procedures
- Configure required tax codes/tax rates
- Configure VAT determination logic in SAP
- How to link VAT relevant transactions from other sourcing systems into external interfaces

Assess impact on Product Master Data

- Analyse current master data structure and propose VAT relevant settings:
  - Determine the tax classification in either taxable, zero rated, exempt or non taxable

Assess impact on sales process

- Include automated VAT determination in sales order process
  - Define VAT sensitive data in sales transactions (product, customer)
  - Include VAT sensitive data in VAT determination rules (condition records)
  - How to manage currency conversions from VAT perspective
- Include VAT transaction data from other billing systems into external interfaces
- Instruction: use of tax codes for manual sales invoices

Assess impact on Customer Master Data

- VAT identification number
- How to assign ‘tax rules’ to customers: default is taxable
- Review customer master data
Assess impact on purchase process

- Include automated VAT determination in purchase order process
  - Define VAT sensitive data in purchase transactions (product, vendor)
  - Include VAT sensitive data in VAT determination rules (condition records)
  - How to manage partially deductible input VAT if applicable
- Alternative: manual selection SAP tax code in AP process
  - Instruction: use of tax codes for manual sales invoices

Assess impact on Vendor Master Data

- VAT identification number
- How to assign ‘tax rules’ to vendors: default is taxable
- Review Vendor master data

Assess impact on reporting

- Are new reports required due to VAT
- Configure VAT return reports and deliver business user training for VAT reporting