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EU VAT FORUM
WORKING DOCUMENT

DOCUMENT ELABORATED BY
THE BUSINESS EXPERT GROUP (BEGV):

DOING BUSINESS IN PAST AND PRESENT TIMES
How to deal with the complexity of a pan-European VAT world
1. INTRODUCTION

The importance of VAT at many levels has, over the last few decades, both for businesses and governments (tax administrations), increased significantly. Member States’ budgetary needs will continue to increase, due in part to the current economic situation and as a consequence there are and will continue to be significant increases in VAT rates and thus VAT will become even more important in the future. For businesses and their global operations, VAT, and its underlying collection process, have become increasingly difficult to handle, with major risk factors associated for both tax administrations and businesses.

Looking back 20 years, VAT was handled within businesses mainly by their accounting departments; it was a very ‘local’ tax, with few, if any, cross-border transactions being undertaken. Today the VAT landscape in a business is very different. Both legitimate businesses and tax administrations face tremendous challenges in today’s pan-European VAT world.

Multi-national enterprises (MNEs) have had to build up specialised internal VAT resources in the tax, accounting and IT departments, and still, they are struggling to manage and comply with their VAT obligations across the European Union (EU). For SMEs, who have fewer or no internal human and technical VAT resources, it is even more difficult. For tax administrations a comparable situation seems to apply. It has become much more demanding for tax administrations across the EU in today’s VAT landscape to manage their day to day VAT tasks and monitor and audit businesses’ VAT collection processes. Additionally, fraudsters have systematically attacked the EU’s VAT system and budgets in the last few years, stealing from the Member States (MS) and taxpayers, creating a major threat for legitimate businesses and society as a whole.

Businesses and tax administrations clearly have common interests (paying/receiving the right amount of tax at the right time, from, and to the right person). Both parties, therefore, require a safe, fair, simple and easy way to handle the VAT system in order to manage VAT across the EU in a resource and cost efficient way. It is critically important, as a consequence, that both legitimate businesses and tax authorities enter into a constructive dialogue at EU level to identify in practice what can be done to improve the efficiency of the pan-European VAT system. The focus of this dialogue needs to be on the EU Single Market and the functioning of the EU VAT system. In other words the dialogue must be clearly directed at dealing with practical cross-border EU issues which occur for both parties on a day to day basis. Approaching the above mentioned tasks together with this pan-European focus will help all parties tackle and overcome today's most complex challenges over time.

2. AIM OF THIS DOCUMENT

This document has been put together by the Business Expert Group and captures the thoughts and discussions which the group elaborated on during its first meetings. It sets out to explore the practical challenges legitimate businesses and tax administrations face across the EU. In doing so, the Business Expert Group aims to outline the complexity of doing business across the EU taking into consideration both businesses’ and tax administrations’ perspectives and tries to foster a common understanding of today’s practical challenges that both parties face. The business model which is presented later in this document should be seen in this light.

Outlining – on an EU-wide basis – the particularly difficult economic context within which businesses operate today and highlighting areas where and the means by which
simplification, consistency and legal certainty can be gained across the EU are key to starting a debate and developing practical and effective solutions to achieving these objectives for both parties. The Business Expert Group seeks to do this by trying to build a fruitful dialogue and a high level of cooperation between the Commission, MS and businesses, to create a platform which fosters debate and develops common solutions for a smoother and more effective functioning of the VAT system in the EU.

3. THE COMPLEXITY OF A PAN-EUROPEAN VAT WORLD

Businesses operate under a variety of business models having to deal with complex products and services, supply and delivery structures in a highly internationalised and dynamic environment. Globalisation and new technological developments have further accelerated these trends.

The EU Single Market and the current VAT system removed the tax and customs borders between the EU MS, although paperwork involved in doing business within the EU seems to have increased year by year. A major factor for this seems to have been the massive VAT fraud problem which the EU faces and cannot get full control over. This has also led to an increase in VAT reporting obligations for legitimate businesses, tax audits, punctual questions, requests for information etc.

These developments have put legislators at the EU and at national level, tax administrations and tax collectors under enormous pressure, having to deal with new risks and ever increasing administrative and financial burdens. It seems that we are all in a vicious circle when it comes to administering VAT in practice. The ever increasing compliance obligations put a huge burden on both businesses and the 27 national EU tax administrations which now need to audit all of such obligations.

4. VAT IN THE BUSINESS CONTEXT

Business decisions are driven by commercial aspects. VAT issues arise only if and when business supplies occur. However, VAT, being a transaction based tax, has an impact on all business operations and processes (sourcing, sales, finance, legal, logistics, etc.) although it is clearly intended to be neutral for businesses.

In practice VAT has become a significant cost factor for business, driven by high compliance costs, which negatively impact on businesses’ activities and is no longer neutral. The complexity of the VAT ‘environment’ often forces businesses to change their commercial structures in order to mitigate VAT compliance costs (e.g. minimise foreign VAT registrations and/or VAT credits) and to take account of its cash flow implications.

Due to political and economic developments, doing business has changed dramatically in the last few decades. Whereas the “old business model” had more of a local focus – local sales, little cross border activity, local solutions, local systems, local accounting – the “new business model” driven by technological developments and globalisation has led to new global products and (remote) services being supplied across multiple territories.

Businesses operate in dynamic global markets and face global competition. Global markets require global sourcing and a global supply chain. Staying globally competitive means
increasing efficiency through economies of scale driven by outsourcing/centralisation of production and/or sourcing; focusing on core business functions, by outsourcing of supporting services/functions and/or increased use of subcontractors and/or service providers. This increased globalisation of supply chains has led to changes in logistics and to new transport capabilities allowing for example stocks to be owned centrally but located locally (cross border consignment and call-off stock) for ‘just in time’ delivery.

Furthermore, as VAT is levied in over 150 countries in the world, businesses, operating globally, need to work with multiple jurisdictions and VAT systems on a real-time basis.

5. KEY VAT CHALLENGES IN PRACTICE

VAT impacts on a business during its entire economic life – start-up phase, operational phase and liquidation phase. Meeting day-to-day business/commercial needs and being a “good” taxpayer (which means complying accurately and in time with its VAT obligations) is a significant challenge for businesses under the current EU VAT system. The VAT system is tough for businesses from a systems, process and resource perspective and tough for tax administrations, who need to control and audit the businesses´ systems and processes, ideally on a timely basis.

Information is essential for both, businesses and tax authorities, in order to take care of their respective tasks accurately, in a timely and efficient manner – for businesses as VAT collectors to pay the right amount of VAT at the right time in the right jurisdiction – and for tax administrations to control and audit the business´s VAT compliance processes.

Based on the “VAT life cycle in a business” approach, four baskets (legislation, compliance, collection and control/audit) have been identified for which, as can be seen, timely relevant and up to date information plays a key role.
• Legislation: In order to be able to be compliant, businesses need easy access to the relevant regulations. When new legislation is introduced businesses need the appropriate lead time to implement any new legislation into their systems, processes and procedures.

• Compliance: Simplification of and more consistent and standardised compliance practices across the EU are key when it comes to increasing efficiency and reducing compliance costs. Technology can play an important role when it comes to efficiency but it needs to be kept in mind that there is probably, at this stage, no single “push the button” approach.

• Collection: Payment and refund processes need to be further streamlined to avoid cash flow disadvantages and pre-financing costs for businesses. Control/Audit: Businesses’ internal control frameworks can play an essential role when it comes to audits by tax authorities. Modern technology and an enhanced relationship approach can further reduce the duration of audits for both tax administrations and businesses alike.

6. EXAMPLE OF A NEW (PAN-EUROPEAN) BUSINESS MODEL

The below business model is not exclusive and more business models will be shared and discussed as the work of the Business Expert Group progresses. This example, nonetheless, illustrates an actual business structure which reflects millions of underlying business transactions undertaken on a daily basis. It also illustrates some of the changes that have occurred “in doing business” over the last few decades. This example has been selected as it has pan-European coverage and can often be found in business practice today. The list of questions is not exhaustive either. The questions are not meant to be answered, but they just illustrate, tease out and highlight the practical challenges both businesses and tax administrations currently face when dealing with VAT across the EU.

6.1 Outsourcing / Cross Border Stocks

Company A is a mobile phone producer established in MS A. It has outsourced its production to a third party company B (contract manufacturer) in MS B. Company B produces the phones. Company A requires company B to have a stock of phones available in MS C and MS D.

Company A has a sales organisation (legal entity) in MS C and an agent in MS D, which helps company A to sell the phones domestically and cross-border. Company B owns goods in a call-off stock located in the premises of company A’s sales organisation in MS C and in a consignment stock with a local logistics/warehouse provider in MS D, who invoices company A for its services. The goods are sold and shipped from these stocks to company A’s customers.
6.2 VAT related questions

The illustrative questions show a number of important issues a business has to solve in order to make sure it complies with its VAT obligations across the EU. The same applies to the potential questions from a tax authorities´ perspective, which highlights the key aspects from their angle.

6.2.1 Questions from businesses’ perspective

- How can businesses get all of the relevant information they need as regards VAT filing and compliance obligations in a territory outside of their own MS? Is information published and is it easily accessible? Who can provide support to businesses? Do businesses need a local advisor?
- Do I have to register in another MS, or is the reverse charge (article 194 of the Directive) or any simplification relief applicable (e.g. call-off stock, consignment stock relief, etc.)?
- If a registration is required, is it a full registration or only a “simplified” registration?
- How does the registration process work? What documents are required and in which language? How long does the registration process take? Is external support required? Are documents to be notarised or are they required to follow the Hague Convention?
- Can I charge VAT and recover VAT in another MS before I have obtained a VAT registration number?
- Is any triangulation simplification available? If yes, how does it work?
- Is a domestic reverse charge applicable (article 194)? If yes, how does it work? What does that mean for input VAT recovery?
• What about the invoicing requirements in other MS? Can the business’ billing system cope with them? Can the billing system cope with the use of different (multiple) VAT numbers?
• In order to exempt cross-border supplies – what evidence and documents are required?
• Are there any special exemptions for local supplies, e.g., article 164?
• What are the local input VAT deduction rules in other MS and what evidence is required to support that deduction right?
• What has to be reported by when, to whom and in what format? Is the reporting to be done on a monthly, bi-monthly, quarterly or yearly basis? Is any additional reporting such as purchase listings, statements of transactions with customers and suppliers within the MS, or a combination of EC Sales and Intrastat listings required?
• How long does it take to obtain a refund if the VAT return shows that the supplier is in a refund position? Is the reclaim only possible once a quarter or even once a year?
• Can business systems and processes cope with the reporting obligations outside of their own MS? Are any changes and investments required?
• Are new resources required to cope with all of the obligations and to be compliant?
• Where do all the relevant documents have to be stored and for how long? Are paper copies or electronic copies allowed?
• What about the tax audit process in another MS? Can the business communicate with the tax authorities of that MS in English? Are the audits on a regular basis? Are they dependent on turnover or in the case where a refund is requested?

6.2.2 Potential questions from tax authorities’ perspective

• Is there a taxable (VAT) supply in our territory? Is the taxable supply taking place now or in the future?
• Who is the taxable person liable for the VAT?
• How can we ensure that the VAT that is due is paid on time?
• How can we ensure access to systems and relevant documentation?
• How can we establish a regular and timely audit process?
• Can we be sure that the VAT refund applied for is legitimate?
• How can we effectively fight fraudsters?

7. FINAL REMARKS

This document should be seen as a starting point to gain a common understanding as to the administrative and practical EU cross-border challenges, in VAT terms, which businesses and tax administrations face in the current VAT landscape, with the aim of building a fruitful dialogue based on cooperation between the MS and businesses as facilitated by the Commission, as a platform that fosters debate and develops common solutions for a smoother and more effective functioning of the VAT system within the EU.

Businesses needs for “information” to be fully compliant are critical. This could be a first topic to focus on in a joint meeting, as it is a topic which is to the benefit of businesses and tax administrations alike.