Integrated Approach to Global Indirect Tax Operations

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In order to realize incremental gains in efficiency and cost savings many large U.S. multi-nationals have shifted toward global procurement and supply chain models. This is especially true for manufacturers with expansive operations in North, Central and South America, as goods and services are now bought on a centralized global basis. Most U.S. based corporate indirect tax functions have made significant adjustments in their allocation and deployment of resources to effectively manage these expanded tax obligations.

Although, U.S. indirect tax departments usually possess extensive experience with the management of transaction taxes in the form of sales/use tax, the approach required with VAT is drastically different. Historically, U.S. tax departments were primarily focused on the areas of compliance and audit defense with few if any resources dedicated to strategic tax planning or consulting with the business regarding the supply chain. This traditional approach, while effective for sales/use tax can create enormous inefficiencies and situations of non-compliance as the sheer nature of VAT requires a fully integrated approach to compliance and a holistic mindset when consulting with various business groups.

This article is divided into two sections, with the first discussing the major differences between sales/use tax compliance and VAT compliance, and the second focusing on how to effectively structure an indirect tax group to ensure optimal efficiencies for transaction taxes while minimizing non-compliance.

Part I: Indirect Tax Compliance

There are six primary areas of focus associated with indirect tax compliance, all of which are imperative to the overall success of the indirect tax group and most importantly an organization's reputation as a good faith taxpayer. The areas of focus are detailed below, utilizing a compare and contrast of Sales/Use Tax and VAT.

AREA OF FOCUS	U.S. SALES/USE TAX	VALUE ADDED TAX
COMPLIANCE FOOTPRINT	Currently, 7500+ jurisdictions administer a sales tax. The tax can be administered at State/County/City and district levels creating varying degrees of complexity regarding registrations as jurisdictions require taxpayers to obtain the appropriate license or registration prior to engaging in sales activity. Non-compliance with licensing requirements can adversely impact business operations in the form of liens, revocations, and closures. Understanding the scope and nature of business operations (i.e. knowing what goods/services are being sold, where these goods and services are being sold, and how they are being acquired) is fundamental in U.S. Sales and Use Tax.	Value Added Taxes are usually administered at a Federal level, therefore the management of the registration is not as complex as that of U.S. Sales/Use Tax. In addition, in order to claim input tax credits on purchases a firm must be registered for VAT.

AREA OF FOCUS	U.S. SALES/USE TAX	VALUE ADDED TAX
TAXABILITY	Sales and Use Taxes are by nature exceedingly complex as exemptions, exclusions and deductions create ambiguity regarding the taxability of goods and services. Thus requiring tax technical individuals to be in constant contact with business operations regarding the nature of goods and services bought or sold. Moreover, an exorbitant amount of documentation needs to be maintained (in the form of exemption and resale certificates) in order to substantiate non-taxed transactions under audit.	The taxability of transactions in a VAT environment is rather straightforward. Virtually all goods and services are taxable under VAT with very few exemptions or exclusions and therefore less expertise is required when making a decision regarding taxability. Moreover, cross border transactions which have historically plagued sales/use tax (sourcing and situsing issues) seem to be much more manageable under VAT as export sales are usually exempt in most countries.
TAX CALCULATIONS	The calculation of sales/use tax can be a rather tedious process if not automated, as there are 7500+ jurisdictions imposing a sales/use tax. That equates to a significant number of rates and complex sourcing issues. Taxes are administered at State, County, City and District levels requiring corporations to either purchase software to automate rates or maintain a very labor intensive rate gathering/verification process. Incorrect rates can lead to class action/whistle blower lawsuits.	In comparison to sales/use tax there are significantly fewer VAT rates, since they are on a country by country basis. Thus the management of VAT rates is easier with fewer opportunities for error.
DATA MINING	Data mining and extraction is the starting point for sales tax compliance. The identification of the appropriate data feeds from tax feeder systems or the general ledger is critical, to the overall compliance process as well as ensuring the accuracy of tax location codes utilized and calculations.	Data mining is critical to VAT compliance as this process encompasses virtually every aspect of a firm's business operations. Therefore, ensuring the completeness of the data inputs for the returns is critical to accuracy and the overall performance of the function. As missing input credits and or erroneously reported sales figures can create serious compliance issues. Furthermore, a significant amount of backup documentation needs to be maintained in addition to the original hardcopy invoices to ensure input tax credits can be substantiated.

TAX TRILOGY

AREA OF FOCUS	U.S. SALES/USE TAX	VALUE ADDED TAX
RETURN PREPARATION and FILING	Sales/Use tax return preparation is primarily driven by data and heavily process orientated due to large return volumes. Moreover, tax forms, due dates and filing methodologies differ from jurisdiction to jurisdiction. Items such as filing frequency, account numbers, prepayment thresholds and methodologies as well as the treatment of tax credits must be maintained as part of the return preparation and filing process. Any issues or discrepancies discovered need to handled immediately to ensure timely and accurate filings.	With significantly lower return volumes than sales/use tax, VAT compliance is not as process oriented rather an exercise in data validation for completeness and accuracy. However, VAT remittances are usually a substantial hit to the business' bottom line.
RECONCILIATIONS	Reconciliations should serve as a check and balance on sales/use tax compliance ensuring all liabilities have been accurately captured for reporting. Moreover, the liabilities identified on the return usually reconcile to those captured in the general ledger; however there are valid exceptions.	Reconciliations are fundamental in the VAT compliance realm as it is imperative for organizations to capture all purchase and sales activity in order to properly claim the correct amount of input tax credits or collections. Therefore, a tremendous amount of time and attention should be utilized in validating the amount of tax paid on purchases and the amount of tax collected on sales as the VAT chain should not be broken. A breakdown in the chain can easily result in the loss of recovery opportunities and an exorbitant amount of tax as an expense.

To further the discussion regarding the operational structure, U.S. Corporate Indirect Tax Departments must consider when consolidating all indirect tax reporting. Assume the following:

A large U.S. based multi-national manufacturer with annual non-U.S. Revenues of $1.0B would have approximately $300MM in throughput VAT. As such, even if the manufacturer is 99.4% accurate (which would be at the high end of compliance in a Six Sigma "Black Belt" process), the manufacturer would "bleed" $1.8MM as either an overpayment or underpayment.

NON-U.S. REVENUES	THROUGH-PUT	IMPACT
$1 Billion	$300 Million	$1.8 Million - $20.1 Million
$2 Billion	$600 Million	$3.6 Million - $40.2 Million
$5 Billion	$1.5 Billion	$9 Million - $100.5 Million

TAX TRILOGY

Comparatively, in a sales and use tax environment assume only 1% of the manufacturer's domestic revenues are subject to a retail sales tax. Also assume an average tax rate of 7% and accuracy rate of 80%. As displayed, the negative effect to the company's bottom line is far less impactful than in a VAT environment.

U.S. REVENUES	U.S. REVENUES - RETAIL	IMPACT
$1 Billion	$10 Million	$140K
$2 Billion	$20 Million	$280K
$5 Billion	$50 Million	$700K

Therefore, the allocation and deployment of resources in a VAT environment is more heavily geared toward effective cash management and tax planning. A visual representation of this is given in the below diagram:

AREA OF FOCUS	SALES/USE TAX	VAT
PLANNING and CONSULTING	3 FTE's*	6 FTE's
COMPLIANCE	5 FTE's	2 FTE's
AUDIT	4 FTE's	2 FTE's

* FTE Denotes Full Time Employee

As can be referenced above, sales/use tax can be more challenging to manage. There is a greater need for back-end support with sales/use tax compliance, whereas VAT is more front-end loaded. This is due in part to the scope and magnitude of VAT when compared to sales and use tax. Also it is important to note the amount and level of expertise required to manage the VAT Planning and Support function as it is not always a one for one equivalent with US sales/use tax. The individuals responsible for this function need to be integrated with business operations, ensuring transactions are structured in the most tax efficient manner. Mapping the VAT supply chain process and validating that all components are operating effectively is critical.

PART II: Organizing and Structuring Your VAT Team

VAT Team Model

In VAT, or any indirect tax function, it is critical to have knowledgeable resources supporting each facet of the operation. This knowledge and expertise cannot be limited to understanding the administration and mechanics of VAT, but must also include an in-depth grasp of the various business activities and supporting systems that give rise to VAT implications on purchase and sales activities.

Each VAT resource will have a specific skill set that must be strategically placed so as to provide the best chance of success for both the company and the individual. For purposes of this article, let's assume that the standard VAT Team is segmented into three basic groups with the following roles and responsibilities:

• VAT Planning and Support Group
    o Works with billing department to ensure VAT logic is properly applied to sales activities/systems, and all necessary components are present on the outgoing invoice to the purchaser (i.e. name, address, and VAT registration numbers of both seller and purchaser, unit price and amount excluding VAT, VAT amount, and issue date of invoice)
    o Assists with business initiatives and system implementations/launches to ensure proper VAT treatment
    o Establishes controls and procedures with procurement/payables groups to pay applicable VAT to suppliers on purchases, and ensure that the VAT payable is properly captured and documented to claim as input credit
    o Reviews contract terms and the structure of payables transactions to promote efficiencies within the supply chain and procurement functions (i.e. cash-flow maximization and global/centralized procurement proficiency)

- VAT Compliance Group
  - o Supports month-end close process by either writing journals or advising various groups on matters related to general ledger activity
  - o Reconciles, analyzes, and mines data inputs for the VAT return process to confirm the validity and integrity of the VAT amounts and processes
  - o Completes the necessary VAT returns and payments via paper or electronic means, ensuring timely filing and payment (if applicable) on a monthly basis
  - o Works closely with the jurisdictions on various administrative matters related to VAT filings, such as notice management, refund or offset follow-up, registration issues, and compliance related requirements

- VAT Audit Management
  - o Works intimately with the auditing jurisdiction to develop the audit plan, while internally assessing previous audit results and business environment changes to devise an effective audit strategy
  - o Defends positions to successfully reduce or eliminate assessments at the conclusion of the examination
  - o Memorializes audit results to identify and communicate exposure areas such as inadequate documentation, process issues, supply chain inefficiencies, and lack of controls
  - o Maintains various databases to house appropriate billing and payables data, invoices, and supporting documentation (i.e. terms and conditions contracts for various supplier and customer relationships)

This model may vary depending on the business, but it is representative of a standard allocation of VAT resources and processes.

VAT Team Synergies

In order to maximize the output of this model, we first have to understand how these groups must collaboratively interact.

VAT Planning and Support < - - - - - - - - > VAT Compliance

- Planning and Support Group to communicate new input credit or collectible transactions to the Compliance Group to include in the VAT return process
- Compliance Group to verify or validate non-standard input credits and collectibles with the Planning and Support Group who have established close working relationships with the business groups responsible for the transactions
- Planning and Support Group to relay to the Compliance Group new or unique business activities requiring initial or revised registrations

VAT Compliance < - - - - - - - - > VAT Audit

- Audit Group to work closely with Compliance Groups to understand the source of the input credits and collectibles, and all work papers and reconciliations that accompany the VAT return compliance process
- Compliance Group to communicate any outstanding refunds or credit amounts on the VAT account to Audit Group for consideration in current audit cycle
- Audit Group to relay process issues identified in jurisdictional examination to Compliance Group that are related to return preparation (i.e. allocation methodologies and classification of input credits/collectibles)

VAT Planning and Support < - - - - - - - - > VAT Audit

- Planning and Support Group to communicate known issues to Audit Group related to billing, payables, and systems that would represent exposure in current or future audit cycles
- Audit Group to communicate audit results to Planning and Support Group to implement appropriate corrective action and improvement initiatives
- Audit Group and Planning and Support Group to work closely together to share ideas on best strategies and go-forward action plan to streamline VAT processes and positively impact the company's bottom line

An important dynamic to consider when assessing the teams' cohesiveness are the different workflows and day to day priorities of each group:

Planning and Support Group – as this group represents the "catch-all", their priorities could shift quite often depending on the initiatives of the business that require VAT expertise. Their work is more project-oriented with constantly changing deadlines, as often times outside resources (i.e. business support, IT support, supplier or customer cooperation) are required to complete projects. A typical day of the Planning and Support Group is in no way typical as the business groups will come to the Planning and Support Group first with any vendor disputes or VAT inquiries. To better manage the scope of their workflows, the Planning and Support Group may be further segmented to have X resource(s) support data and systems matters, Y resource(s) to be the gatekeeper for vendor and business requests, and Z resource(s) dedicated to process controls and contract reviews.

Compliance Group – this group works on a monthly cycle, where the first week or week and a half of the month is dedicated to supporting the ledger close process and gathering necessary data inputs to feed the VAT returns. The next week is dedicated to analyzing the VAT return data for tolerances and accuracy (often scrambling to receive information from the business for various amounts), and preparing the necessary work papers and funding documentation. Once the VAT amounts are validated, the funding approved and processed, the returns/payments are filed and remitted to the jurisdiction. For cash management purposes, all refund returns should be filed as soon as amounts are validated and finalized, and payment returns filed as close to the due date as possible (without risking late filing/payment). The remainder of the month is dedicated to managing notices, resolving previous month issues for next month, and continuing to improve compliance controls and processes.

Audit Group – this group is always behind the times, defending the company's VAT positions in three year (or more) cycles. A great deal of time may be spent negotiating the audit plan and terms with the jurisdiction, all before any data or documentation changes hands. Once the audit plan is developed, information and documentation requests (IDRs) must be fulfilled. This, also, can be a painstaking and cumbersome process depending on jurisdictional requirements and the company's ease of accessibility of sales and purchase data sets and invoices, and necessary contractual documentation to support the transactions. Once the IDRs are fulfilled the review process can begin, where work papers will be handed back and forth various times during the audit. Negotiations and legal positioning (or full-on litigation of issues assessed) on the back-end may also increase the turnaround time of the audit. Depending on the audit inventory of the company and other factors related to the auditors' workload, the conclusion of the exam could take 1 to 3 years (or more). Although the VAT Audit Group's goals and responsibilities are of a more focused and defined nature (successfully defend the company's VAT positions against every jurisdiction that initiates an audit) their work function can often be sidetracked by the will and inflexibility of the auditors.

Considering the different work cycles of the three groups, how can the VAT Team's overall efficiency and effectiveness be maximized?

• Shared Process Inputs – often times when the compliance and audit processes are initially developed they are designed independently using inputs that are most easily accessible (i.e. bare minimum to get the job done. For example, the Compliance Group may use summarized or consolidated VAT data from the general ledger or other consolidation system that facilitates the return preparation process. By contrast, the Audit Group will require transaction level detail (which should reconcile to the same inputs used by the Compliance) to support and be used as the basis for invoice retrieval and review. Dedicating more resources in the early stages of process development to ensure the Compliance and Audit Groups use as many common inputs as possible can greatly streamline processes for both functions. (See figure 1.1 and 1.2)

- Real Time Data and Document Retention – establishing robust and centralized databases for invoices, data sets, and other documentation provides incredibly valuable tools for the entire VAT Team. Updating shared repositories each month will streamline the audit IDR process, provide relevant support for questions or issues related to compliance processes, and give complete transparency and visibility of current state to the Planning and Support Group to better facilitate project work and business/supplier inquiries. Centralized repositories could include SharePoint sites, invoice imaging systems (for both sales and purchases), workflow applications, and Access databases housed on local shared drives.

- Reconciliation Redundancies – there may be various reconciliations performed by the VAT Team on a monthly, quarterly, or annual basis (or multi-year reconciliations for audits). When developing reconciliation templates it is beneficial to use a standard format across groups, or most preferably, an all-inclusive reconciliation that can be utilized universally. For example, the Compliance Team may perform a reconciliation of the inputs to the VAT return against the balances/activity within the applicable general ledger accounts each month. Depending on the jurisdictional requirements and the Audit Group's internal processes, a second reconciliation may be performed to compare VAT returns against the VAT transactional detail, payments as shown from the jurisdiction's end, or the general ledger balances. Creating a robust, all-inclusive reconciliation that serves multiple purposes will allow the resources to focus on more value-added functions. (See figure 1.1 and 1.2)

- Team Logistics – although not always practical, an ideal situation for team chemistry and knowledge sharing is best achieved when the VAT Groups are located within the same space. Modern technology has improved the ability to communicate across great distances, but maximum efficiency and overall strength of the VAT Team will be greatly benefited by working cohesively day in and day out in the same location.

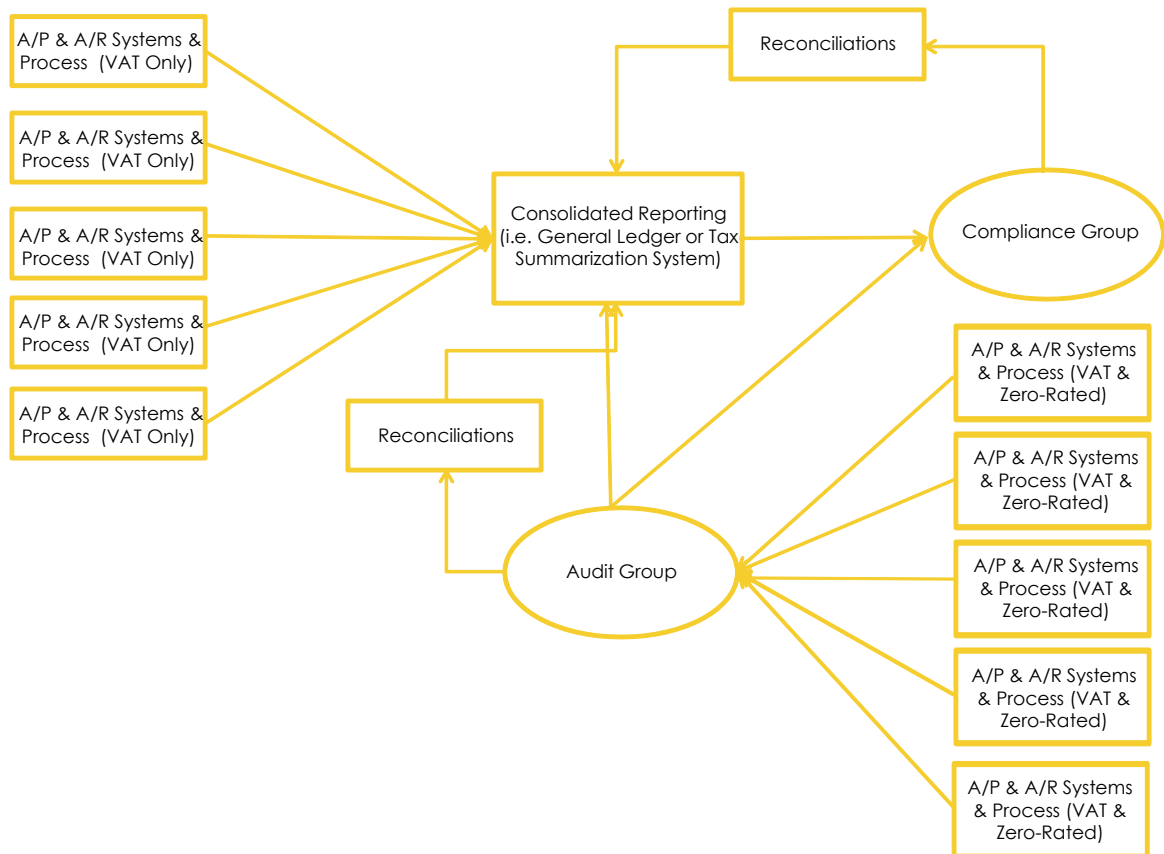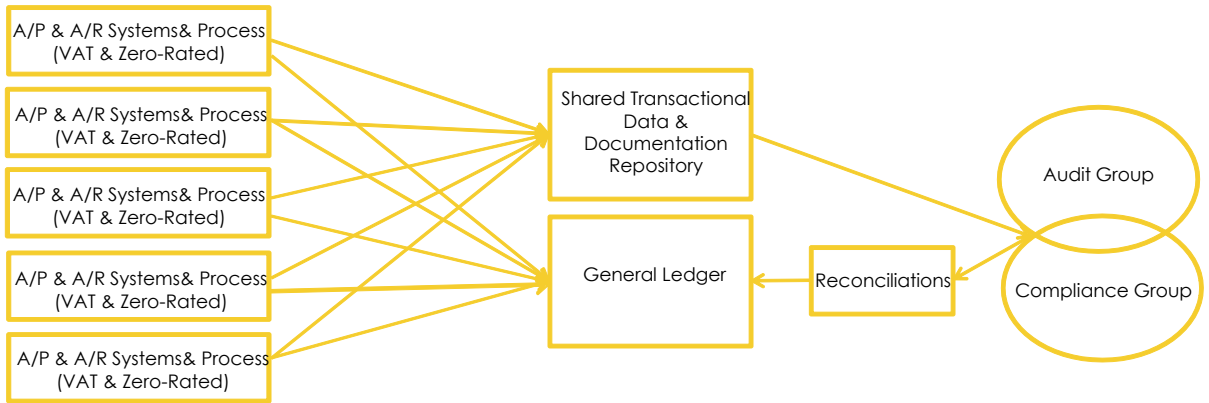Figure 1.1 – Example of Redundant VAT Processes

Figure 1.2 – Example of Congruent VAT Processes

Figure 1.2 – Example of Congruent VAT Processes

Conclusion

As U.S. based companies continue to move toward more global models, the demand for VAT expertise increases exponentially. Careful consideration must be given when expanding the company's global tax operations to meet the needs of the evolving business activities. Strategic tax planning, proper resource allocation and elimination of redundancies are all imperative to the long-term success of the VAT function.

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Mr. Hazely is responsible for the management of all indirect tax compliance engagements and implementations. This includes the critical functions of development and oversight of the implementation plan, establishment of the tax filing calendar, treasury and production functions for all clients; which currently represents annual return volumes in excess of 15,000 and remittances exceeding $190 million.

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