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Advanced VAT Issues for U.S. Corporate Tax Departments

Meeting Challenges With Accounting Systems, Refund Timing, Tax on Warranty Contracts and More

THURSDAY, SEPTEMBER 6, 2012

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Advanced VAT Issues for U.S. Corporate Tax Departments Seminar

Sept. 6, 2012

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Today's Program

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Britta Eriksson, Euro VAT Refund Inc.

INTRODUCTION

U.S. Sales Tax

- Assessed only on goods, not on services generally
- Only paid by the end user (business or private person)
- Is a cost to the business when it has to be paid
- U.S. is almost the only country in the world that has sales tax instead of VAT.

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Value-Added Tax

- Consumption tax is added to most goods and services in all levels of the production and distribution chain.
- Implemented tax in most countries in the world except the U.S.
- Is almost never a cost to the business
- Is a cost to the private person

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Samples Of VAT Names And Rates

Australia	GST	10%
Canada	GST	5%
China	VAT	17%
France	TVA	19.6%
Germany	MWST	19%
UK	VAT	20%

Most EU countries are around 20%.

Rates are "standard rates." They can be lower on some items, and sometimes "zero-rated."

How VAT Works

Almost all companies:

1. Collect VAT on all sales invoices

2. Pay VAT on all purchase invoices

3. Declare the difference to the VAT authorities

4. Pay VAT on the value that is added

VAT is accounted for on a balance account and is usually not a cost.

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VAT On Transactions: Sample The UK

Purchase from UK vendor	50,000
VAT 20%*	10,000
Paid to UK vendor	60,000
Sale to UK customer	100,000
VAT 20%*	20,000
Total collected	120,000

* VAT is not considered a cost or revenue - accounted for on balance account

VAT On Imports

VAT will be assessed by customs on imports to the "VAT countries."

Sample: Import to the UK

Value of shipment	£100,000	
Duty 3%	3,000	Pay to customs
Value for VAT	£103,000	
20% UK VAT*:	£20,600	Pay to customs

* VAT is usually refundable to companies - not refundable to private persons

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VAT Declaration To The Tax Authorities And Margin

VAT declaration:

Collected VAT (output VAT)	20,000
Less paid VAT (input VAT)	-10,000
Due the tax authorities	10,000

Margin:

Revenue from customer	100,000
Less cost	50,000
Margin	50,000

VAT Number In The European Union

The 27 European Union (EU) countries have a coordinated VAT system.

Companies that trade within the EU countries can usually use the VAT number of one country for all transactions.

Sample: The UK company can purchase and sell goods from and to all the EU countries, using their UK VAT numbers. It is similar to trading between the U.S. states.

The non-EU company can usually register for VAT in the EU without having an establishment.

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VAT Numbers In The Rest Of The World

The VAT number can only be used in one country.

Sample: The Brazilian company can only trade within Brazil under its VAT number. If the company purchases and sells to other countries, it will be like a regular export/import.

The non-Brazilian company cannot register for VAT only. It has to have an establishment in Brazil.

Euro VAT Refund

Mark Houtzager, US VAT Inc.
Britta Eriksson, Euro VAT Refund Inc.

REGISTRATION TRIGGERS

When Is Registration Required?

A company must register for VAT when the supplies made are taxable with VAT. This can be 0%, a reduced rate or a standard/higher rate.

- Imports of goods followed by a sale
- Domestic purchases of goods followed by a sale
- Some cross-border sales of goods
- More

However, if the VAT liability on the supplies is shifted to the buyer (“reverse charge”), then there is *generally* no registration requirement.

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More Registration Triggers

- Online services (downloads) sold to individuals in the EU
- Organizing events, tradeshows
- Shipments of products for clinical trials
- On-site construction project management
- Renting or buying office space with the purpose of concluding sales
- Buying and selling goods within any country, or the EU

Bottom line: There is no “establishment/nexus” needed to be required to register for VAT!

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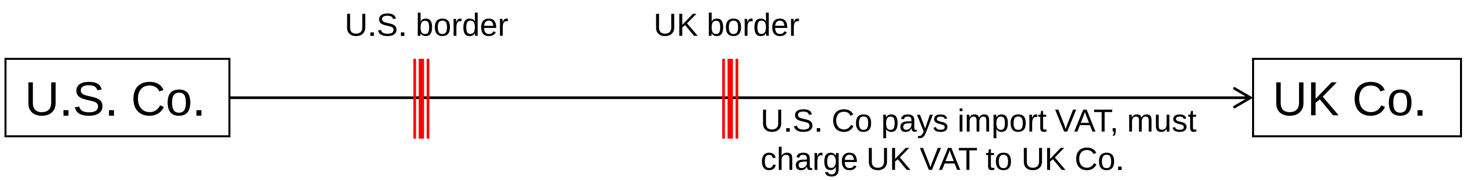
Practical Examples (1)

Importer of record

U.S. company (U.S. Co.) sells goods to UK company. U.S. Co ships from the U.S. and imports goods in the UK. Incoterms is <u>DDP</u> (delivery duty paid). U.S. Co must pay import VAT (recoverable).

U.S. Co must charge UK VAT to UK Co.

Registration is required.



Practical Examples (2)

Drop shipments

U.S. company buys goods from UK company. U.S. Co ships from the UK warehouse of the vendor directly to the UK buyer.

U.S. Co must charge UK VAT to UK Co.

Registration is required.

UK vendor

UK vendor must charge UK VAT to U.S. Co.

U.S. Co.

U.S. Co must charge UK VAT to UK buyer.

UK buyer

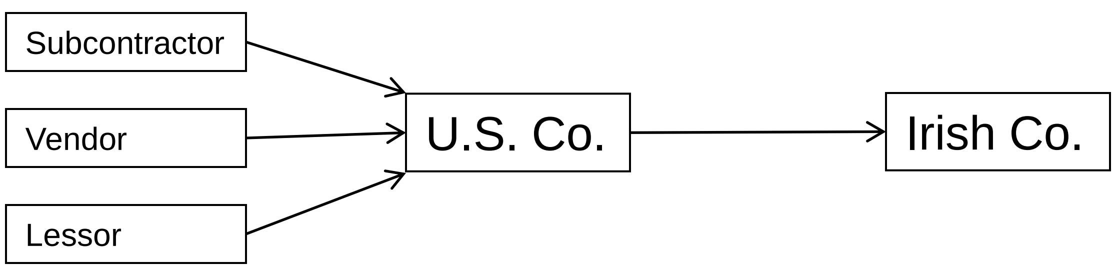
Practical Examples (3)

Construction

U.S. company contracts with a company to build a power plant in Ireland as a principal contractor. U.S. Co purchases/rents materials and equipment locally. U.S. Co also rents a temporary office and storage. Staff remain on-site for an extended period (for example, more than a year).

U.S. Co must charge Irish VAT to Irish Co.

Registration is required.



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Practical Examples (4)

Repair services to individuals

U.S. company contracts with a Polish company to repair hard drives for EU individuals. Individuals send their broken hard drives to Poland for repair.

U.S. Co must charge Polish VAT to the individuals on the repair fees.

Registration in Poland is required.

Britta Eriksson, Euro VAT Refund Inc.
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RELATED E-COMMERCE ISSUES

Online Downloads

Example

U.S. company sells games and software to EU-based individuals. No hardware, manuals or boxes are shipped.

Local VAT is due at the rate of the customer's country.

Registration required *in every EU country*.

Simplification:
If U.S. Co is only required to register for this type of transaction, and is not VAT-registered in the EU, then registration in *one country* is sufficient.

On that one VAT return, VAT must be reported and remitted based on the rate of the customer's countries.

Sales Of Goods Through EU Web Sites

U.S. companies can enter into contracts to sell their goods through online providers in the EU countries

- Often means the U.S. company has to import the goods and sell within the EU

- Means the U.S. company has to register for VAT in at least one of the EU countries

Sales Of Goods Through EU Web Sites (Cont.)

Sample: Sales of products through a UK website:

1. U.S. company must register for VAT in the UK.

2. U.S. company must pay duty and 20% VAT to UK customs, when the goods are imported to the UK.

3. U.S. company must charge 20% VAT on the goods sold on the Web site.

4. U.S. company must declare the VAT and have the liabilities.

Shoab Malak, Deloitte Tax

EXPORTS AND IMPORTS

Exports

- VAT is not generally charged by the supplier if:

  - Goods are sold to an non-EU individual, and the sale involves the export of the goods to a non-EU country.

  - The goods are exported outside the country within the specified time frame.

  - Sufficient documentary evidence is held to prove the goods were exported outside of the country.

- If criteria are not met in the specified time frame, then VAT could be due.
- Most countries in and outside the EU will apply a 0% VAT rate on exports.
- Consideration of VAT recovery on export costs – where business is in a net refund position:

  - In certain jurisdictions, refunds are not available.

  - In China, there is a calculation that may limit the recovery percentage.

Imports

- Buyer may be required to account for import VAT when goods arrive in its country, depending on the jurisdiction concerned.
  - In general, the buyer will be able to treat the import VAT as input tax on the VAT return following importation.
  - Potential negative cash flow hit, but some countries' simplification procedures may delay the payment of the import VAT
- Most countries with a VAT regime will have VAT on imports.
- Import VAT is based on customs value.
- Important to consider who is paying import VAT on the importation of the goods vs. who is able to recover the import VAT (i.e. importer of record)
- Specific documentary evidence for imports

VAT Considerations

Sale of goods from a U.S. company to a customer in a VAT jurisdiction*

US Company

Goods shipped value of $ 100

Customer

Import VAT and customs duty paid to tax authorities at the time of import

Goods sold for $ 100

US Company acts as importer of record

Import VAT paid $ 15

VAT collected from customer $ 15

Local VAT return

Sales (output) VAT	$ 15
Input VAT (import VAT)	$ 15
Net amount due to tax authorities	$ 0

* Assumed VAT rate of 15% used

Dispatches Within The EU

VAT is not charged by the supplier if:

•Goods are sold between two EU countries.

•Both parties (i.e., vendor and buyer) are situated in separate EU countries.

•Both parties are VAT-registered in their respective EU countries, and the buyer purchases the goods for business purposes.

•The vendor quotes the customer's VAT registration number on its invoice.

•Sufficient documentary evidence exists to prove the goods were dispatched out of the supplying EU country within the specified time frame.

Acquisitions Within The EU

- Buyer accounts for acquisition tax when goods arrive in its EU country.

- The buyer treats the acquisition tax as both output tax and input tax on the same VAT return.

- No cash flow hit; only an accounting mechanism

- Vendor and buyer can be the same entity, if the company is moving own goods around the EU (e.g., to hold goods on inventory).

Mark Houtzager, US VAT Inc.

MANAGING CASH FLOW

Why Is Cash Flow Relevant For VAT?

Even though interest rates are currently low, effective VAT management is required to:

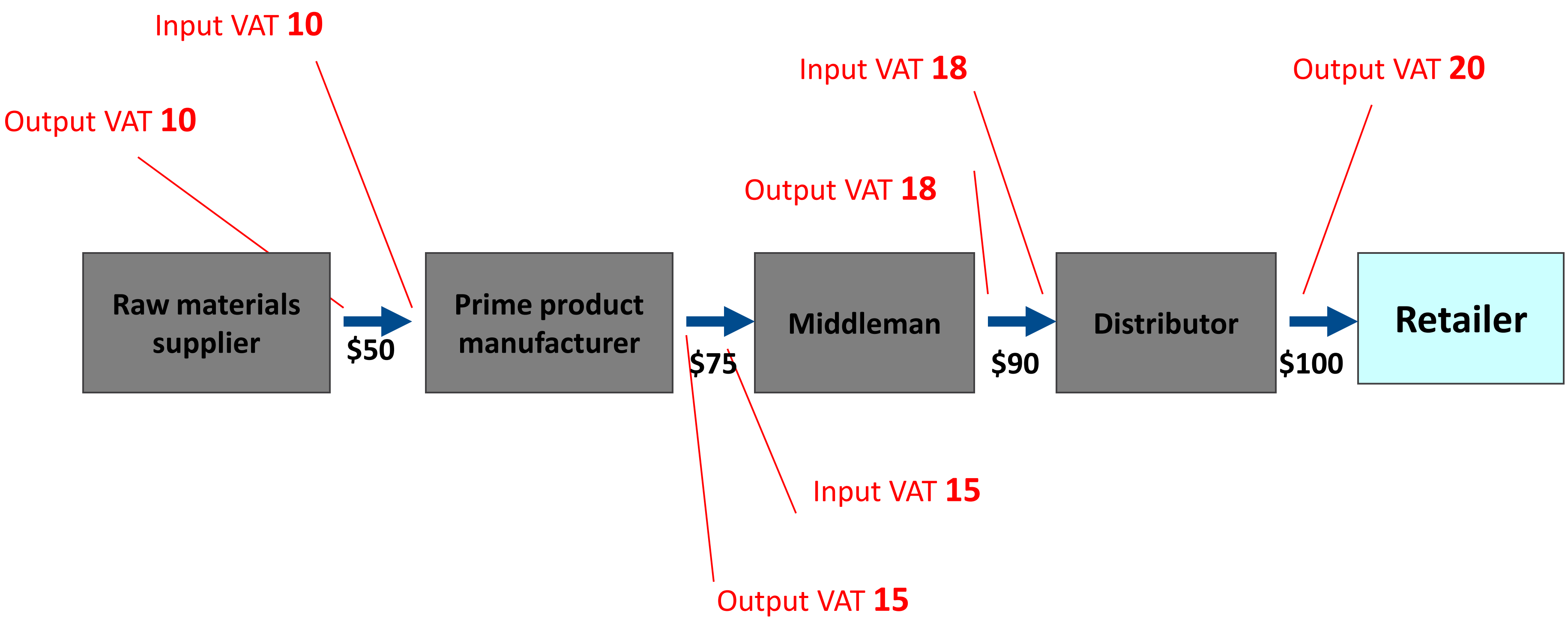
- Identify situations where VAT becomes a cost
- Improve working capital
- Streamline business flows
- Manage tax registrations and compliance costs
- Manage global tax ‘footprint’

Also see the VAT blog at www.us-vat.com/blog

VAT Impact On Cash

Assume VAT = 20%

VAT in the supply chain: 106



VAT Impact On Cash (Cont.)

(Assume all sales are local)	$ million	VAT @20%
Non-U.S. sales (local)	100	20
Cost of goods sold	-50	10
Salary costs	-10	
Expenses	-15	3
Profit	25	
Total cash VAT throughput		33
Corporate income tax (30%)	7.5	
Net VAT payable		7

VAT affects all non-U.S. sales, purchases and imports. The total VAT amount that must be <u>managed</u> is between 30% and 45% of gross non-U.S. sales.

Practical Examples: Reverse Charge

Related to the economic downturn:

- Under Italian law, VAT on local supplies made by a non-resident is subject to reverse charge.
- Italy has difficulty paying VAT refunds.

Overseas manufacturer or warehouse → (Import VAT payable by US importer) → Italian warehouse of U.S. supplier → (Reverse charge) → Italian buyer

There is no output VAT to offset the recoverable import VAT. Import VAT may become a cost.

Remedy: Locate warehouse in Switzerland or south of France, or let buyer import the goods

Practical Examples: Warranty

In-warranty deliveries outside the EU:

A retailer sells a widget to a local customer. The widget breaks down within the warranty period. Per the warranty agreement, the customer sends the widget to a local repair shop.

Depending on the local VAT rules, the repair shop bills you, with local VAT.

Local repair service → Invoice with VAT → U.S company

Local repair service ↓ delivery ↓ Local customer

If the country does not pay VAT refunds, VAT will be an additional warranty cost.

Practical Examples: Drop Shipments

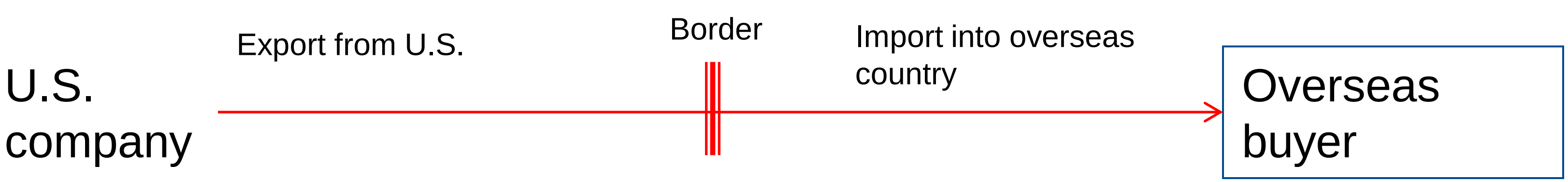
A U.S company sells a widget to an overseas customer. The U.S. seller uses a courier service, like FedEx, UPS or DHL.

Who is the “importer of record”? The importer pays all import taxes and duties.

Courier services *by default* assume that the <u>shipper</u> is the importer.

If the importer is not VAT registered, import VAT becomes a cost. Importing goods may even trigger a registration requirement!

Ensure that for drop shipments, the recipient / buyer is the importer!



Mark Houtzager, US VAT Inc.

IMPROVING VAT REPORTING

What Is The Standard VAT Filing?

VAT reports must be filed by registered businesses. Residency is not always required.

The VAT return is the backbone of VAT filings:

- Monthly
- Quarterly
- Yearly

Also, in the EU:

- Filings of sales of goods and services to another EU country
- Filings of purchases of goods and services to another EU country
- Statistical filings

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There Is More

Audit reports, worksheets and business documents on which the VAT filings are based are equally important. They support:

- The output tax, based on invoices sent
- The input tax, based on invoices received
- Reverse charges, on accounts payable and receivable
- Status of the customer (business/individual)
- Application of zero-rating of exports
- Reduced rates
- Blocked VAT on certain expenses

Don't underestimate the impact of VAT on your organization.

Where Tax Affects The Organization

Product Generation	Order Generation	Order Management	Plan *(Planning)*	Source *(Procurement)*	Make *(Production)*	Deliver *(Logistics)*	Service Delivery	Financial Management and Reporting	
Manage Design Classification & Retrieval	Manage Marketing Processes	Manage Customer Credit Exposure	**Identify, Assess & Aggregate Supply Chain Resources**	Establish New Materials	Maintain Manufacturing Master Data	Manage Logistics Network Planning	Maintain Installed Equipment Data	**Manage Trade Accounts Receivable**	Perform Sales Analysis
Manage Component Specification	**Manage Demand Creation**	**Create Orders**	Identify, Prioritize & Aggregate Supply Chain Requirements	Establish New Sources	Request & Receive Material	Manage Warehouse Logistics	Manage Startup Service Scheduling & Delivery	**Manage Trade Accounts Payable**	Perform Cost of Sales Analysis
Manage New Product Introductions	**Manage Sales Execution**	**Manage Orders**	Balance Supply Chain Resources & Requirements	**Maintain Source Planning & Execution Data**	Manage Shop Floor Scheduling and Sequencing	Manage Inbound Logistics	Manage Call Receipt & Logging	**Manage General Ledger**	Perform Expense Analysis
Manage Product Structure & Representation	**Manage OG Administrative Processes**	**Bill and Collect Revenue**	Establish Supply Chain Plans (MRP, MPS, etc.)	Manage Sourcing Business Rules	Execute Make-to-Stock Production	Manage Inventory Storage and Movement	Manage Call Qualification	Manage Payroll, Assets & Cash	Manage Standard Setting
Maintain Material Master Data	Manage Alternate Channels	**Manage Complaints (returns & corrections)**		Manage Vendor Certification	Execute Make-to-Order Production	Manage Picking & Packing	**Create Service Orders**	**Manage Material Transactions**	Manage Inventory Auditing
Maintain Bills of Materials	**Manage Customer Care**	**Manage Service Contracts (HW & SW)**		Manage Vendor Agreements	Execute Engineer-to-Order Production	Manage Outbound Logistics	Manage Capacity Planning and Assignments	Perform Labor Vouchering and Cross Charges	Prepare Legal Schedules
Manage Manufacture Process Specifications	Manage Sample Requests	**Manage VMI & Consignment Programs**		**Procure Materials and Services**	Manage Production Quality	Manage Foreign Trade Logistics	Execute Service Delivery	Manage Inventory Valuation	Prepare Periodic Management Reports
Manage Engineering Changes		**Manage Forecast & Release Programs**		Schedule Material Deliveries	Manage Short-Term Capacity	Manage Reverse Logistics (returns)	**Manage Delivery of Consulting and Education**	Manage Mfg Overhead Postings	Perform Profitability Analysis
Manage Discontinued and Obsolete Products				Receive & Verify Material	Manage Production Cell Capacity	Manage Field Repair Parts Logistics	Manage Service Projects	**Manage Taxes**	Perform R&D Project Analysis
Manage Product Data Vaulting				**Authorize Vendor Payment**	**Manage Facility & Equipment Maintenance**	Manage 3PL and VMI Hubs	Manage Product Recalls	Manage Revenue Recognition and Deferral	Perform Service Delivery Analysis
				Manage Material Inventory	**Manage Outsourced Manufacturing**		Manage Service Escalations	**Manage IC Accounts Receivable**	
				Determine Emerging Supplier Technologies	**Manage Regulatory Compliance**			**Manage IC Accounts Payable**	

xxxxxxxxxxx = Tax touch points

Practical Ad-Hoc Queries

Examples:

- Why is my VAT less than expected this month?
- What are my total sales in a given jurisdiction?
- Have we applied EU simplifications where possible?
- What is my VAT on inter-company transactions?

Other Benchmarks Required (1)

Examples:

When do I need to register in a new country?

- Establish thresholds, monitor business flows. Set up a system that allows for advance notifications.

How much non-recoverable input VAT have I incurred to date?

- Monitor and identify non-recoverable VAT. As your budgeted amount is reached, and you are alerted to this fact, it may allow you to adjust future budget numbers.

Other Benchmarks Required (2)

Track potential VAT costs of new legal entities and new business operations:

- A merger or acquisition could result in new VAT costs. Set up alerts to track the actual VAT activity on transactions for given entities.

- Newly developed business or new sales channels may create additional tax challenges (for example, initiating B2C sales in a B2B business).

Track significant sales (for example, greater than $100,000) to ensure tax treatment is in the best interest of the business.

Reporting Tools For Forecasting (1)

Credit card/procurement card charges:

- Identify and optimize VAT refunds for credit card/procurement card charges (including travel, conferences, exhibitions, etc.)

Time sheet management:

- Use time and expense reporting functionality to identify and manage risk of permanent establishment and other overseas tax liabilities

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Reporting Tools For Forecasting (2)

Sample questions:

- What will be my VAT next quarter, given a 5% increase in sales?
- Given expected purchases next quarter, how much should I budget to offset the unrecoverable Input VAT?
- Given the new supply chain, how much VAT will I incur or save in the next quarter?
- VAT rates are to increase in Israel, Spain (both Sept. 1) and the Netherlands (Oct. 1). How does that affect our sales and cash flow position?

Conclusions

VAT reporting must not only focus on the immediate goal of a correct VAT return.

Accessing other reports that are readily available within your organization provides many more tools to manage your global VAT exposure, limit liabilities and improve cash flow.

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Shoab Malak, Deloitte Tax

MERGERS AND ACQUISITIONS/CORPORATE RESTRUCTURING

M&A Deals Or Corporate Restructures

Generally M&A deals/corporate restructuring are structured around transfers of securities or trade and asset transfers, which have significantly different VAT treatments.

I.e., are you selling/transferring:

1) The box (shares in the business); or

2) The contents of the box (assets and inventory only)?

Stock Transactions

- Transfer of ownership of the stock/shares in a corporation
- Typical VAT liability of transfer of shares: Exempt (no VAT charged, but VAT recovery issues)

<u>**Main issues:**</u>

- VAT recovery on associated professional costs, e.g. on the services of accountants and lawyers in local countries; need to consider:
  - The VAT liability of such services
  - The billing arrangements, i.e. centralized vs. localized
- Continued liability in respect of prior VAT compliance and accounting of the company
- Increase in compliance obligations on the buyer in terms of ongoing business

Asset Transfers

- Transfer of ownership in a partnership or assets of a business, e.g. plant, machinery, goodwill, people
- Consists of multiple supplies of goods and services that could be taxable or exempt, for VAT purposes

Main issues:

- Does VAT need to be charged on all or part of the deal price?
- Do any TOGC VAT-specific relieving provisions apply?
- If no such relief applies, you need to identify the VAT liability of each of asset being transferred, including intangibles IN EACH COUNTRY, even if the parties to the transaction are in the U.S.
- Consideration should be given to the need for local VAT registrations and the need to raise VAT invoices, collect and remit VAT, and file VAT returns.
- Compliance obligations on the seller and buyer in terms of the deal and ongoing business, i.e. warranties/legal terms of contracts

Post-Merger Integration

The management of VAT in a newly enlarged or newly formed company is essential, especially as any transitional services agreements expire. The areas where VAT commonly creates risks and costs in these situations are:

- ERP systems: Integration, correct coding of transactions

- Compliance: Registrations/de-registrations, VAT returns, VAT invoicing

- Agreements: Inter-company, global supply/purchase contracts

Key Points To Remember

1. Different VAT considerations arise for different deal structures.
2. Due diligence requirements/risk profile varies accordingly.
3. VAT rates are high, and implications for pricing and VAT recovery must not be overlooked.
4. Assessment must be made of the VAT liability of transfers of assets in local countries. Consequent VAT registrations and compliance infrastructure may be required to be set up PRIOR to completion of the deal.
5. Ensure clear terms regarding prior and ongoing VAT liabilities are incorporated into contracts
6. What are the post-transaction requirements?

Britta Eriksson, Euro VAT Refund Inc.

VAT RECLAIM POSSIBILITIES WITHOUT REGISTRATION

Reclaim Possibilities For Additional VAT

The U.S. company can often reclaim VAT that has been incurred in the EU countries without VAT registration:

- Lodging and transportation
- Conferences and tradeshows
- Import VAT paid to FedEx/UPS on warranty products, samples, goods sold, products for clinical trials, etc.
- Services such as TV productions, services on goods, installation

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“VAT-Friendly” EU Countries

Some EU countries are more “VAT-friendly” than others for U.S. companies:

<u>Most “VAT-friendly” countries:</u>

Western European countries, i.e. France, Ireland, Germany, the Netherlands, the UK, and Scandinavia

<u>Less “VAT-friendly” countries</u>

Southern and Eastern EU countries, i.e. Italy, Spain, Greece, Poland and Hungary

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