Understanding VAT Compliance

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Agenda

• Basics of VAT
• What’s at stake for governments
• The impact on your business
• The components of VAT compliance
• Your VAT compliance alternatives when transitioning to 100% e-business
Basics of VAT

• What is it?
  – An indirect tax: goods or services, not people or organizations
  – A consumption tax: expenditure rather than earnings
  – A “self-assessment tax”: business is tax collector
  – Any sales whether intra or inter company
  – Fastest spreading tax type ever
  – No real difference between VAT and GST

• Why is it popular?
  – For businesses: a “neutral” tax
  – For governments: an effective tax
Contribution to Public Revenue

Approximately 30% of all taxes, which represent over 30% of GDP in OECD countries.
VAT Neutral for Businesses?

• Yes, as regards the tax itself
• No, due to costs of compliance
  – Multiple VAT rates per country, variations
  – Cross-border rules can be very complex, but exports often “zero rated”
  – Internationally trading companies need multiple registrations (numbers)
  – Need for close monitoring through experts: change management
  – Auditability is key and rarely overlaps with other governance requirements: reliable invoice and accounts
  – Filing statistics reports
Invoice Central to Compliance

*Does Not Exist in a Vacuum*
Why the Invoice?

<table>
<thead>
<tr>
<th></th>
<th>Invoice/credit note</th>
<th>Purchase order</th>
<th>Delivery note</th>
<th>Bank statement</th>
<th>Contract</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parties' identities</td>
<td>Green</td>
<td>Green</td>
<td>Red</td>
<td>Yellow</td>
<td>Green</td>
</tr>
<tr>
<td>Nature of the supply</td>
<td>Yellow</td>
<td>Green</td>
<td>Red</td>
<td>Yellow</td>
<td>Yellow</td>
</tr>
<tr>
<td>Price</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Green</td>
<td>Yellow</td>
</tr>
<tr>
<td>Actually paid?</td>
<td>Yellow</td>
<td>Red</td>
<td>Yellow</td>
<td>Yellow</td>
<td>Yellow</td>
</tr>
<tr>
<td>Tax correctly calculated?</td>
<td>Green</td>
<td>Red</td>
<td>Yellow</td>
<td>Yellow</td>
<td>Yellow</td>
</tr>
<tr>
<td>Supply actually performed?</td>
<td>Green</td>
<td>Red</td>
<td>Green</td>
<td>Green</td>
<td>Yellow</td>
</tr>
<tr>
<td>When did the supply take place?</td>
<td>Green</td>
<td>Red</td>
<td>Green</td>
<td>Green</td>
<td>Yellow</td>
</tr>
<tr>
<td>Place of supply</td>
<td>Green</td>
<td>Red</td>
<td>Green</td>
<td>Green</td>
<td>Yellow</td>
</tr>
</tbody>
</table>
VAT Invoicing Mechanism and Risks

Supplier

Buyer
VAT Invoicing Mechanism and Risks

Invoice
Contract price
+ VAT (10-25%)

Supplier

Buyer
VAT Invoicing Mechanism and Risks

Supplier

Payment
Contract price + VAT

Buyer
VAT Invoicing Mechanism and Risks

Supplier

Buyer

Tax authorities
VAT Invoicing Mechanism and Risks
The VAT invoicing mechanism and risks

Supplier

VAT

Tax authorities

Buyer

Deducts VAT paid to supplier from own VAT payments collected on sales

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VAT Invoicing Mechanism and Risks

Supplier

Audit up to 11 years later:

Non-compliant invoice
Contract price + VAT

Buyer

Tax authorities
VAT Invoicing Mechanism and Risks

Supplier

Audit up to 11 years later:
Non-compliant invoice
Contract price + VAT

Fines

Tax authorities

Buyer
VAT Invoicing Mechanism and Risks

Supplier

Contract price + VAT

Non-compliant invoice
Contract price + VAT

Audit up to 11 years later:

Fines

Tax authorities

Buyer

VAT + fines

Fines

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Tax Revenue Mechanism

B1  B2  B3  B4  B5  B6  consumer

10  15  20  25  30  35

0.5  0.5  0.5  0.5  0.5  2.5

Tax administration
Is Electronic Different?

• Viewed as both a threat and opportunity by tax administrations
  – Threat because electronic information is more malleable, open networks exposed and massive automation errors can be catastrophic
  – Opportunity to ease audit (click a button), lower costs through smaller audit surface
  – Data mining “e-audit” opportunities

• Hard to escape different treatment due to massively different treatment in other laws and business practice (IT security market alone is worth >25 billion USD)

• For businesses: technology choices require more investment and thus predictability
Tax Audit Options

- **ex ante audit / partnership**
- **real-time reporting or transaction preapproval**
- **ex post audit**

Invoicing process
Multi-dimensional “Compliance Matrix”

- **Regulatory issues**
  - Hierarchies of rules
  - Geography
  - Legal areas
  - Legal architecture
  - Applicable law
  - Parallel and hybrid invoicing
  - Form and format requirements

- **Business process issues**
  - Invoicing types
  - Document types
  - Internal vs external
  - Roles of trading partners
  - Invoicing flows
  - Operational security
  - Web EDI: carefully architect

- **Technology issues**
  - Standards, formats
  - Archive access
  - Technical security (archive, transmission)

- Moving target: management must include maintenance
- Cost-effective solutions neither oversimplify nor overdo compliance
- Sustainable solutions have minimum structural impact on systems and processes
A Typical Multinational Corporation’s Transaction Environment

- Only 5-25% cross-border, rest multi-domestic
- Average period of 7.5 years during which audits can take place
- Heterogeneous and evolving trading partner environment and interfaces
- Continuous change in processes, systems, people, legal structures
- Need for a single long-term auditability strategy – for the corporation, its subsidiaries and trading partners
Why Would the Auditor Trust Your Accounts?

Types of *ex-post* audit evidence of input source:

- Intrinsic (portable) evidence
- Historical context data (audit trail)
- Internal coherence of complex data
- Historical 3rd party audit reports
The Good Old Paper Days

Verifiable features of the invoice object e.g. paper quality or deterioration, header print type, fold marks, font type etc.

Increased cost (complexity, intrusiveness) of audit - increased risk of penalties and fines

I. Taxable person being audited
   - Invoices (stored messages)
   - ‘Administration’ (other records and books)

II. Trading partner
   - Invoices (stored messages)
   - ‘Administration’ (other records and books)

EXIT
EXIT
EXIT
EXIT

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The Modern Paper World

- Accounting data audit using e.g.:
  - Automated ERP data analysis
  - XRBL reports
  - SAF-T reports

- Historical process controls information e.g.:
  - Approval signatures
  - Invoice content validation rules
  - System logs in screen-based approval processes

- Historical audit reports in relation to electronic process components (ERP system, workflow systems) e.g.:
  - SAS70
  - ISO27002
  - COBIT

Increased cost (complexity, intrusiveness) of audit - increased risk of penalties and fines

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Signatures as a First Line of Defense

Verifiable features of the invoice object e.g. legally recognized electronic signature

Increased cost (complexity, intrusiveness) of audit - increased risk of penalties and fines

I. Taxable person being audited

Audits

Invoices (stored messages)

'Administration' (other records and books)

EXIT

II. Trading partner

Invoices (stored messages)

'Administration' (other records and books)

EXIT

EXIT

EXIT
The EDI Method

Accounting data audit using e.g.
- Automated ERP data analysis
- XRBL reports
- SAF-T reports

Historical EDI controls information:
- Interchange agreements
- System and process documentation
- Data conversion mapping tables
- Invoice content validation logic
- System logs
- Summary statements

Historical audit reports e.g.
- SAS70
- ISO27002
- COBIT

Increased cost (complexity, intrusiveness) of audit - increased risk of penalties and fines

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- Invoices (stored messages)
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II. Trading partner
- Invoices (stored messages)
- 'Administration' (other records and books)

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Business (Internal) Controls

Accounting data audit using e.g.
- Automated ERP data analysis
- XBRl reports
- SAF-T reports

Historical trade data e.g.:
- Purchase orders
- Delivery notes
- Remittance advice
- Bank statements
- Contracts

Historical business or exchange controls information:
- Interchange agreements
- System and process documentation
- Data conversion mapping tables
- Two, three or four-way matching logic
- System logs
- Summary statements

Increased cost (complexity, intrusiveness) of audit - increased risk of penalties and fines

I. Taxable person being audited

Audit

Invoices (stored messages)

'Administration' (other records and books)

II. Trading partner

Invoices (stored messages)

'Administration' (other records and books)
e-Invoicing Outlook Webinar

- The role of governments, service providers and global users in e-invoicing
- The current status and developments of global e-invoicing
- The e-invoicing business case
- The options for implementing e-invoicing and which are future-proof and global
- e-invoicing best practices
Questions?

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