

How to Manage VAT in a Borderless World of Global Trade?

VAT Trends in European Union: Lessons for Asia-Pacific Countries

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How to Manage VAT in a Borderless World of Global Trade? VAT Trends in European Union

- **VAT is a mandatory step to belong to EU Community**
- **When VAT was implemented in Europe:**
 - borders existed
 - customs check points were active
 - very few distance selling, or cross-border trade of intangible services
 - no e-business
 - most sales were done by entities which were established in the country of consumption

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VAT Trends in European Union

- Payment of VAT was done to the Customs based on the destination principle
- Exports were zero rated and imports were taxed
- Those were not the best days for trade theorists- but were good days for Tax and Customs administrations
- What theorists would see as trade frictions allowed tax administrators to implement a tax instrument, the VAT, which has highly desirable characteristics such as: neutrality, efficiency, and simplicity.

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How to Manage VAT in a Borderless World of Global Trade?

VAT Trends in European Union

- Since 1993 goods and services are travelling all over EUMSs without Customs control
- More and more businesses are not established in the country of consumption (NETP)
- The e-business is growing very fast, and difficult to control intangibles and services are becoming as important as tangibles
- B2C is growing fast
- Since 1993, trade theorists are much happier, tax administrators less so.

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How to Manage VAT in a Borderless World of Global Trade? VAT Trends in European Union

- There are now 27 VAT regimes, more than 12 different standard rates, 27 registration thresholds, 27 sets of exemption
- 27 registration rules, 27 procedures for filing, payment and audit, and 27 processes for VAT refunds, 27 kinds of organisation and computer systems not being compatible
- The differences in administrative procedures constitute very important Non-Customs Tariff barriers to trade
- However, most of the studies about VAT are confronted with tax policy issues and not with the differences in the administration of the VAT and their consequence on the cost of compliance for cross-border traders

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How to Manage VAT in a Borderless World of Global Trade? VAT Trends in European Union

- If borders have been abolished for trade of goods and services, they are still present for VAT auditors who
 - cannot travel to another country to audit the turnover of the supplier, cross-check the files and books,
 - barely speak the relevant foreign language, and
 - have to follow very painful processes of enquiries to exchange information with other EU Tax Departments
- The common perception in EU is that the European VAT is currently an open door to tax evasion and tax fraud
- “Tax authorities now recognize that VAT needs to be adapted to the borderless world of Global Trade”.

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How to Manage VAT in a Borderless World of Global Trade? VAT Trends in European Union

- Chapter 1 depicts the current procedures to manage the VAT in the EU for NETPs
- Chapter 2 deals with the recent efforts made by the EU to simplify the collection process and to improve the tax audit for cross-border trade
- Chapter 3 draws conclusions and presents lessons for Federated States in the Asia-Pacific Region and for countries embarked in Regional Trade agreements

How to Manage VAT in a Borderless World of Global Trade? Chapter I Main Issues in European Union

- The present VAT system requires businesses to pay VAT in the EUMS where consumption of the goods they supply takes place.
- The result is that many businesses have to pay VAT to a EUMS where they have no permanent establishment (PE).
- The main issues are : (1) Registration; (2) Filing; (3) Payment; (4) Refunds; (5) Audit; (6) Exchange of information; and (7) Mutual Assistance.

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How to Manage VAT in a Borderless World of Global Trade?
Main issues in European Union: REGISTRATION

- Since 1993, the concept of zero-rate has been shifted to a concept of intra-Community transactions for interstate trade within EUMSs
- Importation of goods and some importation of services done by a registered VAT business in one EUMS from another registered VAT business established in another EUMS must follow the “reverse charge mechanism” (RCM)
- The RCM allows the supplier to not charge VAT to his customer. The customer must remit the VAT to the Treasury. He will thus be in a position to offset this payment against the input tax deduction. Thus any flow of money which is currently being exploited by fraudsters is avoided

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How to Manage VAT in a Borderless World of Global Trade?
Main Issues in European Union : REGISTRATION

Why a NETP should have to be registered in the consumer state?

- Reverse-charge cannot apply to final consumers.
- The foreign suppliers, NETP, engaged in B2C must have been registered previously with the tax department in the state of the consumer
- A registered VAT business in one EUMS selling goods or services in each other EUMSs has to be registered in each of them, and should follow 27 different procedures to get the registration number that must be indicated on invoices

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Main Issues in European Union: REGISTRATION

Where to Register?

- Registration of NETP depends on the organization of the tax department. Some countries have set up a national unit to register all NETPs without any tax representative (France)
- Some countries have set up tax offices to register, based on the nationality of the NETP. In Germany there are 36 offices for NETP
- One national tax office helps to generate statistics
- Specialized tax offices by country help to provide better service to taxpayers

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Main Issues in European Union: REGISTRATION

How to Register?

Procedures to register are different in each country:

- In few countries, the application to register can be downloaded from a web site (France, Spain)
- Applications should be filed only in the State's language or may be filed also in other languages
- Some explanation is provided in foreign languages (France, Belgium, Italy, Germany)
- How long does it take to be registered and to get the TIN? Time vary from one to six weeks

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Main Issues in European Union: Documentation to attach to the Registration Application

- Most tax departments request a certificate of VAT registration in one EUMS and some request the address of the tax office managing the file
- Other documentation requested include:
 - Business plan, orders from customers, and forecasting of turnover for the next two years
 - Bank account certificate
 - Trade Office registration certificate
 - Contact address in the country of consumption
 - Place where books can be audited within the country of consumption
 - Certificate of incorporation
 - Identity of the claimants

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How to Manage VAT in a Borderless World of Global Trade?
Main Issues in European Union: REGISTRATION
No single TIN

- The “structure” of the VAT numbers allocated by each EUMS are all different
- This does not help traders who must put these numbers on their invoices or tax services to cross-check information
- Without a unique European identifier it is difficult to profile taxpayers. Taxpayer or client profiling is an essential step in the risk management process and risk management is critical for any effective compliance enforcement program. ¹⁴

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Main Issues in European Union: Filing

Periodicity of VAT returns

- VAT returns have to be filed quarterly in most EUMS. In UK returns are quarterly and in Italy annual. Monthly returns are requested if the turnover or the VAT due is important and for permanent exporters
- Thresholds vary amongst countries and some thresholds are based on the turnover whereas other thresholds are based on the VAT liability
- Some countries request annual returns of inter-states trade (UK, Germany, Spain, Belgium) to summarise the annual turnover by customers or suppliers when this turnover is higher than a pre-determined threshold

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Main Issues in European Union: Procedures for FILING

- Some examples of the 27 procedures:
 - In Germany, declarations must be done through the Internet
 - In Spain only if the annual turnover is more than 6 million of €
 - In Italy, e-filing is mandatory but with many exceptions
 - In Belgium, this e-filing procedure is open only for accountants
 - In France the e-filing procedure is legally compulsory, it is still yet technically impossible
 - In UK and many other states, only paper forms can be used
- Some VAT services request the inventory of VAT invoices for each customer and some nothing

How to Manage VAT in a Borderless World of Global Trade?
Main Issues in European Union: Collection

- In some EUMS, VAT collection and enforcement are integrated within the tax office in charge of the files (France, Germany)
- In other countries, collection and enforcement are assigned to one single national unit, independent from tax offices (Belgium, UK)
- Finally, in other countries, collection is done by private banks (Italy, Spain), and enforcement by tax offices
- In Germany, payments by electronic wire is compulsory for NETP while UK encouraged payment by e-wire by providing an additional 7 days to pay

How to Manage VAT in a Borderless World of Global Trade?
Main Issues in European Union: REFUNDS
NETP With taxable activities (6th)

- **Businesses registered in one EUMS and engaged in trade in other EUMSs can claim refund in these States when VAT on inputs exceeds VAT on outputs.**
- **Most countries apply domestic rules to refund NETPs**
- **No documentation has to be attached to the returns**
- **Time to process varies from 10 days to 3 years**
- **To speed up the refund process, a bank surety is eventually required**
- **As these refunds are processed by all tax offices, no national statistics are available (#Belgium)**

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Main Issues in European Union: REFUNDS

NETP importing goods & services without making any supplies (8th)

- A business registered in one EUMS can buy goods or services in another EUMS without making any supplies and has to support VAT
- A business can take part in a trade fair and buy goods and services used in this country and not zero-rated.
- Under the 8th Directive, the conditions to get a refund of VAT on inputs are the following:
 - not registered in the EUMS from which you are claiming a refund
 - do not make any supplies there other than supplies of goods and services under the RCM and international transportation
 - have no permanent establishment
- Rules for claiming input tax, for payment, and appeal vary and each EUMS has set up a minimum amount that can be refunded. Annex 1 details the main rules in the EUMS

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Main Issues in European Union: REFUNDS

Refunds for Non EU members (13th)

- In some EUMSs, businesses are refunded provided the additional conditions are met:
 - The country of the claimant allows similar concessions to the EUMS' traders (UK, Estonia).
 - and a written agreement of reciprocity has been signed (Spain, Germany)
- A tax representative is mandatory to proceeds (Italy, Estonia)
- Some expenditures are excluded
- The amount of VAT to be refunded per calendar year must be more than a fixed amount (different for each country when applicable)

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**How to Manage VAT in a Borderless World of Global Trade?
Main Issues in European Union: AUDIT**

How to audit?

- Tax fraud in EUMS accounts for approximately 2 to 2.5% of GDP, i.e. between €200 and 250 billion for direct and indirect taxes.
- Fraud is growing at an alarming rate concerning the actual level of VAT losses, with figures ranging from 60 billion € to 100 billion € per year
- As a general standard, tax auditors do not travel abroad to audit the books of NETP
- “It is regrettable that in a single market where fraudsters can operate unhindered by borders, the tax authorities still work in isolation from each other and it is so difficult, if not impossible, for them to “cross” the borders between them”
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**How to Manage VAT in a Borderless World of Global Trade?
Main Issues in European Union: How to AUDIT?**

- Some EUMS have authorized the presence on their territory of tax officials from other MS
- In UK, tax auditors may travel abroad to audit foreign companies provided:
 - The books of account are difficult to be sent in UK;
 - The NETP asks formerly to be audited at the headquarter in an another EUMS;
 - The NETP will support all the cost of the tax audit (transportation, accommodation, and food); and
 - The local tax department has given its agreement to the audit done by the UK tax audit department.
- Results of multilateral and simultaneous controls are disappointing, not effective, and not efficient as they are very costly in time and money
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How to Manage VAT in a Borderless World of Global Trade? Main Issues in European Union: How to AUDIT?

- Most audits are limited to refund claims because supporting documentation is requested. No audit on sales because books are located in foreign countries

To try to improve the effectiveness of tax audit, some countries

- require a NETP a local address where the books can be audited
- call for the originals of all invoices while others request only an electronic list of invoices
- have set up a computerised risk analysis based on pre determined criteria or indicators and some others countries have not
- double-check the refund claims which increase the delay before proceeding at the refund

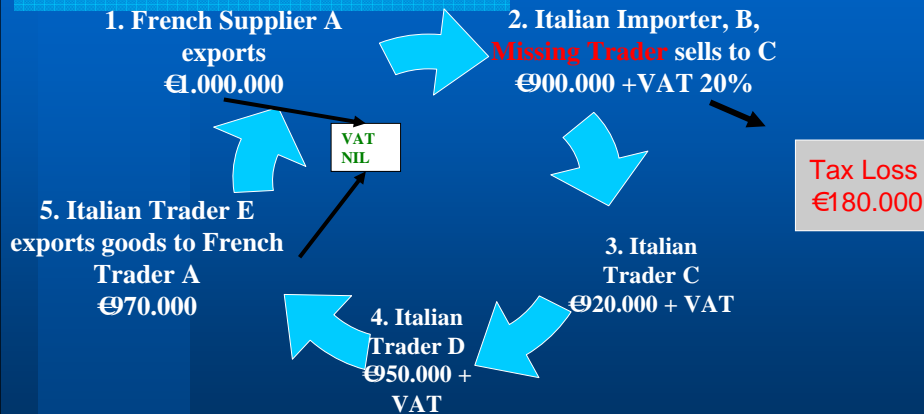
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How to Manage VAT in a Borderless World of Global Trade? Main Issues in European Union: Exchange of Information

- VAT carousel fraud, which involves two or more countries, is one of the most important issues of the “VAT without borders”. It is impossible to fight tax fraud in isolation
- On the subject of exchange of information, progress has been very slow
- It is evident that “current cooperation mechanisms are either under-used by the Member States (VAT and excise) or inadequate (direct taxation and assistance in the recovery of taxes)” EU Press release 31 May 2006

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MTIC VAT Missing Trader Intra-Community fraud Carousel fraud



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How to Manage VAT in a Borderless World of Global Trade? Main Issues in European Union: Exchange of Information

- Three categories of information exchange are provided for: on request, automatic exchange, and spontaneous
- Information exchange must be through a central liaison office to which principal responsibility shall be delegated for contacts with other EUMS
- To date, very few spontaneous or on request exchange of information has been realized.
- All tax services complain about the delay to obtain information (often six months to one year) and about the quality of information received: information is non-understandable, useless or irrelevant, or come too late.

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How to Manage VAT in a Borderless World of Global Trade?
Main Issues in European Union: Exchange of Information

- The 1992 Regulation provided provision for an electronic data base and for automatic communication to all EUMS of the total value of all intra-Community supplies to taxable persons identified in those MS, together with the relevant VAT identification numbers
- EUMS should maintain an electronic database in which it stores the following information for at least five years:
 - VAT identification numbers issued
 - Total value of all intra-community supplies of good (VIES)
 - However, it is very difficult to take advantage of the VIES:
 - only dealing with movable tangible property and not with services
 - Domestic IT systems cannot be interfaced between EUMS or at the national level (no single TIN)

How to Manage VAT in a Borderless World of Global Trade?
Main Issues in European Union: Mutual Assistance

- *“When the assets are located abroad, tax officials cannot seize and sell such assets....One solution to this problem is the use of mutual assistance in a tax treaty network”*. Professor Yoshihiro Masui
- Despite such provisions being included in European directives and in most tax treaties since many years, the procedure is so long and complex that it is barely carried out to conclusion on time.

The requested authority is not obliged to supply information:

 - which would disclose commercial, industrial or professional secret;
 - if recovery of the claim would create economic or social difficulties
 - if the administrative burden is disproportionate or claim > 5 years old

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**How to Manage VAT in a Borderless World of Global Trade?
European Union Recent Trends: A Strategy to combat tax fraud**

To combat tax fraud, the EC proposes to:

- (1) Modify the current VAT system;
- (2) Simplify and securing declarations;
- (3) Improve administrative cooperation;
and
- (4) Other measures

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**How to Manage VAT in a Borderless World of Global Trade?
European Union Recent Trends: A Strategy to combat tax fraud**

Modifying the current VAT system

A move to the origin principle ?

- Better because it can be applied without border controls and the potential for tax fraud would be lower
- However, the origin principle needs a “clearing mechanism” to channel the VAT to the country of consumption
- Discussions on this best choice may turn up again
- Hybrid system? Standard EU rate on intra-community supplies?

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**How to Manage VAT in a Borderless World of Global Trade?
European Union Recent Trends: A Strategy to combat tax fraud
Extending the Reverse Charge Mechanism**

- The main benefit of the reverse charge mechanism is that the foreign supplier does not have to register and account for VAT in the customer's country
- This is less compliance costly and easier to audit
- There is a clear trend in EU to expand as much as possible the reverse-charge mechanism on services

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**How to Manage VAT in a Borderless World of Global Trade?
European Union Recent Trends: A Strategy to combat tax fraud
Extending the Reverse Charge Mechanism**

- Germany and Austria asked authorisation to apply the RC on domestic transactions
- This mechanism would apply to all B2B supplies of goods or services where the invoice value > €5 & €10,000
- If they would have been approved, these measures would have eliminated one of the main characteristics of VAT, which is the fractionated payment
- However, the European Commission has objected to the derogation requests

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How to Manage VAT in a Borderless World of Global Trade?
European Union Recent Trends: A Strategy to combat tax fraud

Electronic portal for non EUMSs

- Since 2003, the EU directive requires collection of VAT in the EUMS of consumption on services and intangibles including e-services provided by non EU- providers
- Non-EU e-commerce providers are required to register in one EU country when offering services to private consumers & charge VAT
- Providers of e-services have to file quarterly, electronically, within the tax Department of the country of registration with the breakdown of the turnover for each EUMS (electronic portal). Then the tax Department remits the amount due to each EUMS
- This procedure will save businesses from having to submit VAT returns in every EUMSs in which they have non-business customers
- However, the process is slow and some countries complain. Some countries attract most of the e-businesses: low standard rate of VAT, weakness of audit

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European Union Recent Trends: A Strategy to combat tax fraud

Implementation of a One-Stop-Shop for all transactions

- A one-stop-shop mechanism would allow a trader to register only in the EUMS where he is established and to use a single VAT number for all supplies
- VAT declarations would be made to one single electronic portal and would be submitted automatically to the different EUMSs to which the trader supplies goods or services
- Payments would be made directly to each of the EUMS of consumption
- The main advantage of this mechanism is that it could work without a full harmonisation of VAT obligations.
- The deadline to refund would be reduced from 6 to 3 months with an interest of 1% per month of delay
- However, this “simplification” in filing and payment procedures is still under consideration and should not be implemented before 2010 or 2012.

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How to Manage VAT in a Borderless World of Global Trade?
European Union Recent Trends: A Strategy to combat tax fraud
Use of proxy for services and intangibles cross-border trade

- **The taxation of cross-border services and intangibles under a "pure" consumption test can lead to complex situations difficult for businesses to manage and impossible for tax administrations to control**
- **A practical set of commonly agreed proxies should be designed**
- **Proxies should be easy to comply with and easy to administer, with minimal scope for diverging interpretations or disputes.**
- **Proxies can limit the cost of compliance but still the issue of audit remains**

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How to Manage VAT in a Borderless World of Global Trade?
European Union Recent Trends: A Strategy to combat tax fraud
Improving Administrative Cooperation

- **"Increasingly, tax administrations are finding that bilateral tax co-operation is insufficient to tackle the tax administration issues of today's open and more integrated economy".**
- **Although bilateral & multilateral agreements, tax treaties and conventions have this kind of provision since many years, it is far from being efficient**
- **Not only because of the lack of common culture between tax administrations but mainly because of the difficulty to accept some loss of sovereignty**
- **Cooperation cannot replace in-the-field audits**

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How to Manage VAT in a Borderless World of Global Trade? European Union Recent Trends: A Strategy to combat tax fraud Simplifying and securing declarations

- Tax fraud does not stop at the EU's external borders.
- The Commission proposes a Community approach to cooperation with third countries.
- The Commission proposes to include tax cooperation clauses under the economic partnership agreements that the Union concludes with its partners.
- The OECD-Council of Europe Convention on Mutual Administrative assistance in Tax Matters provides for a variety of forms of multilateral administrative co-operation between parties in the assessment and collection of taxes, including VAT.
- However, as mentioned by Mr. Angel Gurría, Secretary-General of the OECD: "The benefits of the Convention increase as more and more countries ratify it".

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How to Manage VAT in a Borderless World of Global Trade? European Union Recent Trends: Securing declarations

The Commission also proposes discussing more specific measures such as:

- increasing tax declaration obligations for companies considered to represent a risk
- reducing these obligations for companies which enter into a partnership with the tax authorities
- the use of standardised, high-performance IT tools for the rapid exchange of information
- new ways of exchanging information, such as sharing common databases

To share common databases, **a single TIN is a prerequisite** and sharing information will never replace a comprehensive field-audit of books and accounts. **How to open borders to tax auditors?**

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**How to Manage VAT in a Borderless World of Global Trade?
The real Challenge is how to find a way to capture the net VAT
liability of foreign businesses without physical presence?**

- **A one stop shop cannot help to fight against missing traders, underreporting, and making false refunds**
- **Administrative cooperation and mutual assistance will not solve the issue**

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**How to Manage VAT in a Borderless World of Global Trade?
The real Challenge is how to find a way to capture the net VAT
liability of foreign businesses without physical presence?**

- Logic suggests that, in federalist systems or trade communities, the best choice is:
- a single law (one VAT rate, minimum and similar exemptions)
 - origin principle for interstate transactions
 - a simple clearance mechanism to channel the revenue to the states of consumption
 - a single tax administration to manage and audit the VAT

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How to Manage VAT in a Borderless World of Global Trade? Implementing a multi-jurisdictional tax office

If states want to keep sovereignty on the rate, scope of exemptions, thresholds, and other features of the VAT laws, and at the same time want to abolish borders as a tax point, then there are two ways to effectively combat the fraud:

- to implement a **single Federal (or member-states wide) Tax Administration**, or
- to implement at least a **multi-jurisdictional VAT audit unit for cross-border activities**
- In both cases, a common set of procedures and penalties should be implemented through a **common Revenue Administration Act (RAA)** ⁴¹

How to Manage VAT in a Borderless World of Global Trade? Implementing a Revenue Administration Act (RAA)

An RAA should provide:

- for a common set of administrative rules applicable to income tax, VAT, and excise duty. Implementation can be done progressively: 2 States and VAT only
- for common rules & procedures for registration, filing, refunds, and audits
- the tax departments with more effective and cross-border powers to recover unpaid tax

This will reduce complexity, the costs of compliance and administration and tax planning temptation

How to Manage VAT in a Borderless World of Global Trade? Implementing a federal tax administration (ISRA)

Once a common RAA has been enacted, it is advisable to implement an autonomous body, an “Inter-state Revenue Authority” (ISRA) managed by a Managing Director solely responsible to a board

- This board will comprise of delegates of each Member State and would have to set up the objectives, approve the budget plan, and scrutinise the results
- This inter-state administrative body should be capable of managing and auditing taxpayers without border constraints.

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How to Manage VAT in a Borderless World of Global Trade? Implementing an Inter-state Revenue Authority (ISRA)

This new structure would derive the following advantages:

- **Autonomous** from MSs and from Federal Govnt
- **Scale of salary disconnected** from public sector
- Managing Director less responsive to the pressure of lobbyists
- Annual budgetary allocation with bonus to be shared
- Independent policy for recruiting and training
- Easier possibility to appoint technical advisors
- Better efficiency of a single tax administration without duplication
- ISRA can be implemented progressively starting by engaging with large traders involved in cross-border transactions

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How to Manage VAT in a Borderless World of Global Trade? Implementing a Central Multi-jurisdictional VAT audit unit

- Any NETP would be subject to VAT audit under a “Joint VAT Audit” (JVAT) mechanism by a team comprising at least two Tax Auditors including one with nationality from the audited business
- This JVAT Audit Unit would be set up as an autonomous body at the inter-state level
- After a final Tax Audit Adjustment Notice has been edited, the revenue collected would be ear-marked to each State based on the tax auditors’ assessment.

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How to Manage VAT in a Borderless World of Global Trade? Conclusion: Lessons for federalist systems or trade communities in Asia-Pacific countries

- **1: A common set of procedures and penalties through a common Revenue Administration Act**
- **2: An autonomous inter-state Revenue Authority combined with a simplified revenue-sharing scheme**
- **3: A multi-jurisdictional VAT audit unit for cross-border activities**

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