Value Added Tax (VAT) Basics: The Why, What, When, and How of Reducing Risks and Identifying Refund Opportunities

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A Value Added Tax (VAT) is imposed by nearly all countries outside of the United States and can apply to any organization, trade or business with international activities/transactions, such as buying or selling tangible goods or intangible services, importing goods or services into a VAT jurisdiction or intercompany supplies with an affiliate in a VAT jurisdiction.

For companies subject to a VAT, understanding the basics about the levy presents an opportunity to reduce risks and even help optimize cash flow with respect to VAT payments and refunds.

Knowledge is power, especially when used in conjunction with Andersen's global team of experienced VAT specialists who can help you to optimize the recovery of VAT within regulatory rules, explore available simplifications, and manage compliance and penalty exposure.

Below are the basics about the VAT:

Why

- Businesses are responsible for the total VAT on both sales and purchases (the throughput of VAT) and not just the net difference.
- With high rates and VAT applying to each transaction, the total amount of VAT in a supply chain can become significant quickly and easily exceed profit margins.
- Pro-active management of VAT is critical for businesses to minimize exposure to collection obligations and maximize opportunities for VAT-efficient structures to claim VAT refunds.

What

- VAT is a transactional tax that is levied on practically all goods and services – generally, *goods* refer to tangibles and *services* refer to intangibles or, more broadly, anything that is not deemed to be a *good* is a *service*.
- VAT applies throughout the supply chain on both business-to-business (B2B) and business-to-consumer (B2C) transactions, including the importation of goods and services and intercompany supplies.
- For most businesses, VAT incurred on business expenses, whether for resale or internal use, is potentially refundable.
- Most VAT rates are higher than sales and use tax rates in the U.S., e.g., the average VAT rate in Europe is over 20%.
- In many countries, VAT is a significant revenue generator (generally less than collections of personal income tax but more than collections of corporate income tax).

Where

- Nearly all countries outside the U.S. impose a VAT; in some countries it is called a Goods and Services Tax (GST) or a Consumption Tax (CT).
- The U.S. is the only member of the Organization for Economic Co-operation and Development (OECD) without a VAT.

When

- In many countries, economic nexus (i.e., a taxable presence arising despite a lack of property or personnel within the jurisdiction) can be triggered from the first sale or purchase and result in liability for the VAT as well as becoming subject to registration requirements.
- For U.S. businesses, this means that every sale (output), purchase, or import (input) activity involving a foreign jurisdiction should be considered from a VAT perspective.

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- VAT should be proactively considered in any M&A activity, whether stock or asset deals, both in the due diligence process to highlight historic exposures and in the pre- and post- transaction structuring to avoid interruptions to the businesses' supply chain.
- Intercompany transactions with affiliates in a VAT jurisdiction generally have VAT implications. Companies should align their Transfer Pricing (TP) policies with their VAT obligations and any changes to TP policies should first be reviewed from a VAT perspective to understand the VAT impact and avoid any adverse VAT consequences.

How

- Review information on international sale and purchase activities and contracts (including draft contracts).
- Consider questions on the input side – purchases or imports on which VAT is paid – including:
    - Is the VAT charged correctly by the vendor?
    - Are VAT credits claimed?
    - Is the VAT recovered through the appropriate registered entity filing?
    - Can the VAT cost be minimized or even eliminated by using different contracting terms?
    - Can VAT cash flow be improved?
- Consider questions on the output side – sales or intercompany supplies – including:
    - Is, or should, VAT be charged and collected?
    - Is the VAT reported and remitted through the appropriate registered entity filing?
    - Can the cash flow on the VAT payment due to the tax authority be improved?
    - Can the VAT obligation be avoided by using different contract terms?
    - Can the compliance obligations be simplified and reduced?

The Takeaway

Learning the basics about the VAT is the first step toward achieving compliance, limiting exposure to collection obligations and penalties, and identifying potential refund opportunities. Contact Andersen's VAT specialists to further optimize your VAT compliance process.

For further information please contact your Andersen advisor.

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