Let's be clear, indirect tax is a business issue

Tackling the commercial and operational challenges of a move to VAT/GST

The amount of government revenue collected through indirect taxes such as value added tax (VAT) or goods and services tax (GST) is increasing. As indirect tax grows in importance, the complexity, frequency of changes and scrutiny are also increasing.

While the move to VAT/GST is often viewed by companies as a fairly simple change, impacting only on the tax and wider finance teams, a typical readiness project is a significant business issue, requiring buy-in and attention (to varying degrees) from the entire organisation. Our work in a number of countries who've recently introduced VAT highlights the sizeable change management hurdles and substantial financial, reputational and tax compliance risks for businesses that slip-up.

Your business should also develop clear strategies to address the pricing and supply chain management issues thrown up by the increasing weight of indirect taxation.

In the second in our series of articles looking at how to steer through the growing shift to indirect taxation,[1] we look at the impact and implications of VAT/GST introduction and how to manage the commercial and operational challenges in an efficient and timely way.

[1] To view the first article 'Rethinking tax: The shift to indirect tax'.

Governments are rethinking tax. Taxation is no longer just about profits, income and wealth. It's about transactions, production and distribution which is leading to a growing focus on indirect tax.

Indirect taxes are levied on the person buying goods or services rather than the company selling them. Today, VAT – the most popular form of indirect tax – raises approximately 20% of worldwide tax revenues.[2]

Unlike a sales tax, VAT/GST is levied on the difference between the purchased and the resale price. As such, businesses can reclaim as well as pay tax, and the net result should in theory be neutral.

The greater emphasis on indirect tax reflects an overall move from taxing goods and services at the point of supply to where they're consumed. It's seen as capturing more of the taxable value from digital business. Governments also like it because they can sustain tax revenues while offering competitive corporate tax rates.

Figure 1: Gauging the cross-functional impact of a move to VAT/GST

	General awareness	Legal accountability	Compliance	IT changes	Pricing changes	Operational changes
Executive level management	✓	✓			✓	✓
Departments						
• Accounting and finance	✓	✓	✓	✓		✓
• IT	✓		✓	✓	✓	✓
• HR	✓		✓			✓
• Legal	✓	✓	✓			✓
• Operations	✓			✓		✓
• Procurement	✓				✓	✓
• Sales and marketing	✓				✓	✓
General staff	✓					✓

Organisational impact

Companies around the world face three levels of transition:

1. New tax (eg Gulf States, January 2018).
2. Sales tax to GST/VAT (eg Australia in 2000, Malaysia in 2015 and Puerto Rico in 2016).
3. Consolidation of multiple taxes (eg India).

Our recent experience suggests that the business impact and implications of a move to VAT/GST is often under-estimated, leading to under-resourcing and allowance of too little time for implementation. Far from being a matter for just finance and tax, the impact touches multiple business operations, in varying degrees (see Figure 1).

Understanding liabilities

Understanding indirect tax liabilities and claims across multinational operations is proving to be increasingly difficult. Key challenges stem from a complex web of place of supply and consumption tax rights, which differ from country to country, between goods and services, and between business-to-business and business-to-customer commerce. Within today's complex supply chains, it's hard to track which territories are touched and whether this could trigger any new liabilities.

Your business should develop a clear overview of where you're liable, what your obligations are, and how these interact across your supply and sales chain.

[2] OECD (2014), Consumption Taxes Trends 2014, OECD Publishing.

This is critical for businesses that are branching out from a familiar jurisdiction into a territory that is implementing a new tax. The 'mapping' of the value chain, including the impacts on cross-border activities, is an important commercial driver that must be considered.[3]

Operational issues

Any changes or new implementations create further operational and systems challenges. These include the need to code expenses, suppliers, sales and customers. You're also likely to need to undertake a detailed contract review and consider the need for new contracts, stationery, invoice templates and import/export licences.

The big question is are you allowing enough time in the implementation project for evaluation, preparation and transition?

Unlike a sales tax, VAT/GST generally provides credit for inputs. Your business will therefore lose money if it misses input data and claims. The data challenge and risk of error are heightened by the fact that while corporate tax returns are yearly, VAT/GST requires monthly preparation and disclosure. Tax authorities are also coming to demand more data, more quickly and are moving to require businesses to produce Standard Audit Files.

Missed information or mistakes can raise costs by preventing your business from claiming full input credit. Just as damagingly, they can impair your reputation with the tax authority and lead to significant penalties. In today's risk-based approach, lapses in VAT/GST can also attract closer scrutiny and investigation of other forms of taxation. You must therefore consider whether your systems are compliant and whether the information from business teams is sufficiently timely, reliable and consistent.

A common but often missed risk stemming from rushed or organisationally disjointed preparation is unintentional profiteering. We've seen instances where sales teams have set out to round up/down the new inclusive-of-VAT/GST prices to come to a clearer figure. But when rounding up, they could be seen as profiting from the shift, which could attract tax authority sanction and reputational damage. It's therefore essential that sales and tax teams work together from the outset.

Pricing issues

VAT/GST raises prices both as a result of the tax and the higher cost of compliance. The impact should be strategically managed. This includes the implications for demand and how the price jump could be managed (eg offer prices). Efficient compliance management would also help to reduce the impact on costs and hence prices. VAT/GST may often be accompanied by reductions in corporate tax rates. Considering how much scrutiny your business is likely to come under as a result of GST/VAT imposition, could some of the corporate tax benefit be passed on to customers to ease the price burden without reducing returns?

[3] Grant Thornton is planning on issuing a further indirect tax update discussing 'value chains' in the near future.

Managing the shift

So how can you get your business ready for VAT/GST and avoid needless strain and errors? Drawing on our recent work with clients moving to new indirect taxes, we believe that there are seven inter-related priorities for smooth transition:

1. Board and business buy-in

Tax teams should develop a clear case for early investment and organisational mobilisation. Alert your board to the challenges and potential pitfalls that other businesses have faced to convince members of the need to allocate enough time and resources.

2. Understand the legislation and the revenue authorities' drivers

VAT/GST differs from country to country and the drivers for implementation also vary. It's therefore vital to understand local requirements and expectations. Work with local tax authorities to understand what they expect and take up opportunities to lobby for removal of unintended consequences prior to the implementation date.

3. Clarify exposures

As indirect taxes become more complex and scrutinised, you must develop global visibility rather than just leaving indirect tax to local teams. Key foundations include mapping your value chain, including where supplies come from and where transactions take place, to work out your exposures and where they reside.

4. Recognise and address the project management challenge

Effective project management is vital. Each of your business units will need to undertake a detailed project management plan in collaboration with key stakeholders to determine time frames and key milestones. Recent experience suggests that allowing at least 12 months to plan and implement will make sure that you're much better prepared. You'll also make fewer initial errors than those who leave the standard three to four months.

So who takes the lead? The move to VAT/GST is a significant business-wide change. Tax leaders may have great technical skills, but they may not have the necessary change and project management experience. The transition therefore needs dedicated change management leadership with input from:

- accounting and finance
- operations
- information technology (IT)
- human resources (HR)
- legal
- procurement
- sales and marketing.

The stating point is documenting and communicating the steps required to implement the identified changes. Once up and running, track progress and assist management in tackling risks to the project so that they can be resolved before they become issues. Operationalising the changes demands tools, systems, data collection and reporting capabilities, as well as training.

5. Priorities for tax teams

The tax team's role in the change management includes providing technical leadership. They would also co-ordinate the due diligence process to ensure that the delivery team has a clear understanding of the end-to-end business implications.

6. Priorities for accounting/finance

Finance teams should review the legislation for complex accounting-related issues to ensure they are addressed early in implementation. They will also need to build data collection systems to populate VAT/GST returns and management into their operational cycle and training.

7. Priorities for IT

IT teams should provide technical leadership on the data and systems implications and any resulting changes in areas such as accounting software. IT would also take the lead in developing standardised user acceptance testing in collaboration with key stakeholders.

Spotlight on Malaysia

Malaysia introduced a GST in April 2015. The experience highlights some of the potential challenges

From the outset, the GST was controversial. The government presented the GST as being fairer than the sales tax and service tax it replaced, setting it at 6%, compared to the previous sales tax of 5-20%. But because the GST covered more goods and services than the previous arrangements, many people felt that it was actually less fair.

To ease the introduction of the GST and win public support, the government granted various exemptions and many goods were zero-rated. Unfortunately, these concessions actually added significant extra complexity to the operation of GST and increased issues during the implementation.

While the change-over was announced 17 months before the GST went live, few businesses understood the true scale of the task or took the time to evaluate what was involved until long after they should already have started work. Having left implementation to the last few months, even weeks in some cases, a lot of the expert support businesses needed had already been hired and the last minute rush to get over the line created needless disruption.

This underlines the importance of proper planning, realistic assessment of resource demands and building in enough time to not only implement, but also test processes and deal with any snags that might arise.

Hit the ground running

The move to VAT/GST is not just a tax issue – it's an organisation-wide challenge and an opportunity to set up the business for a seamless transition to a new regime across the entire value chain, including your people, your suppliers and your customers.

Leaving sufficient time and ensuring effective project management will ensure that you can hit the ground running, enabling you to maximise claims, manage the pricing impact and bolster your reputation with customers and tax authorities.

If you would like to talk about any of the points raised in this article please speak to one of the contacts listed or your usual Grant Thornton contact:

Australia
Tony Windle
E tony.windle@au.gt.com

China
Julie Zhang
E julie.zhang@cn.gt.com

India
Amit Kumar Sarkar
E amit.sarkar@in.gt.com

Malaysia
Alan Chung
E alan.chung@my.gt.com

Puerto Rico
Maria de los Angeles Rivera
E maria.rivera@pr.gt.com

Singapore
Lorraine Parkin
E lorraine.parkin@sg.gt.com

United Arab Emirates
Hisham Farouk
E hisham.farouk@ae.gt.com

United Kingdom
Karen Robb
E karen.robb@uk.gt.com

Grant Thornton
An instinct for growth™

www.grantthornton.global

Grant Thornton International Ltd is a company limited by guarantee incorporated in England and Wales.
Registered number: 05523714
Registered office: Grant Thornton House, 22 Melton Street, Euston Square, London NW1 2EP