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W H I T E P A P E R

Consolidated Transaction Tax Management

The New Model for Global VAT Compliance

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Introduction

Every company that trades globally must manage Value Added Taxes (VAT) or a similar form of indirect tax. Whether you receive or issue an invoice, an accurate tax calculation is required because:

As the *seller*, it is incumbent on you to charge the tax—and if it is not calculated accurately from Day One, customer satisfaction can be directly impacted, payment can be delayed, and (worst of all) the tax liability becomes entirely yours.

As the *purchaser*, it is necessary to allocate the tax liability to the right country and accounts so that the correct tax is recovered from the appropriate authorities. In addition, validating that your vendors are charging the correct VAT has direct financial consequences.

Each time you enter a new national market or tax jurisdiction, you need to learn and manage a new form of VAT/indirect tax. In addition, each time there is a legislative amendment or rate change anywhere in your trading sphere, you need to know how it may affect your commercial operations and be ready to implement the required changes across your business process documents. Ignorance is not an excuse: VAT rules are notoriously changeable and complex, yet you have to comply and be able to prove your compliance.

The challenge is that the processes used today to manage VAT compliance are cumbersome, error-prone and not always accurate. They rely on archaic methods of calculation and are personnel-intensive, with day-to-day tax decisions typically in the hands of customer service representatives and accounting clerks—both of which are high-turnover, minimal-training types of jobs. As a consequence, far too many companies are being burdened with:

- Extensive revenue leakage and cash management issues
- Entirely preventable penalties and fines
- Needlessly high overhead costs as a result of having to fix problems after the fact
- Hours upon hours of time spent by tax departments that could be spent on tax planning

Fortunately, an innovation is being realised on how companies manage indirect taxes such as VAT—an innovation that ensures consistent accuracy, efficiency and control. This paper explores this new paradigm of *Consolidated Transaction Tax Management*, and discusses how an increasing number of companies are leveraging this new model to cost-effectively manage VAT compliance and optimise cash flows on a global scale.

“Invisible Tax” – Visible Burden

How poor VAT management drains the top and bottom lines

We all understand corporate income tax. It is right there on the corporate balance sheet for all to see. But VAT is the invisible tax. As an indirect or transaction tax, it is not itemised on the annual report. Yet it is equally pervasive and quite substantial, affecting more than 20% of a typical company’s cash throughput. Whilst it may be “invisible,” VAT is much harder and much more expensive to administer than corporate income tax. Whether you are the seller or the buyer, you need to ask:

- How accurate is this tax assessment?
- What authorities do I need to report to?
- Can this be recovered?
- Where is the documentation?
- Where is my company’s embedded expertise to help us avoid mistakes?
- How many people-hours are spent working VAT issues? Can I even quantify this?
- How do I present VAT related data to upper management?
- How do I know where my company is exposed?
- How do I know where I need to register to collect tax?

The issue with people and VAT management is particularly pernicious because VAT administration today doesn’t just demand lots of people-hours, it also bleeds highly qualified peoples’ time from higher value tasks. For example, it is almost impossible for a tax department to have time for effective tax planning when they are busy defending the company in Tax Court against audits, or scrambling at the end of each quarter to reconcile VAT issues.

Cascading costs of VAT

Simply put, if your approach to VAT management is wrong, you *will* make mistakes and those mistakes *will* cost you. Here are just a few of the more dire consequences of poor VAT management:

If your invoice is incorrect with regards to VAT, you can not deduct its value on your VAT return.

Incorrectly coding a purchase can result in reclaiming input VAT in the wrong country.

When you have errors, you are not just subject to monetary penalties, but you open up your company to further scrutiny and the prospect of a VAT inspection.

If poor VAT controls are pervasive, you risk losing valuable customers who have no interest in sharing the pain of your inaccuracies and inefficiencies.

If you find yourself audited, and you lack the proper documentation, you are going to have to expend consider time, energy and money defending yourself.

Moreover, if you persist in manually attacking VAT-related problems, quarter after quarter and market after market, your “VAT overhead” will only get larger and larger. You will need extensive processes at the backend of each quarter to rationalise VAT issues, and you will need lots of people (potentially, around the world) to run these processes. Even so, regardless of extensive validation, there will still be unidentified errors creeping through, coupled with weaknesses in the processes. Ironically, the more errors and process weaknesses you actually detect, the less time you have to correct them all—meaning that problems might be spotted, but there is no guarantee that they can all be fixed in a timely and effective manner.

Hence, while VAT may be an invisible tax, *all of this VAT management overhead will eventually be visible on the corporate balance sheet*—as excessive administrative costs, un-forecasted cash impacts in the form of fines and penalties, and so on.

Consolidating and automating

The fact is, managing VAT should not and need not be a cost to your business. If you could both consolidate and fully automate your company's VAT management process, end-to-end, you would be able to:

- Transform the entire process into something easier, more efficient and considerably less costly.
- Inject accuracy, transparency and genuine control.
- Ensure the auditability of the process.

All this is entirely possible. It is being accomplished today by a growing number of companies across numerous industries, including organisations managing tens of billions of euros, pounds or dollars each year in VAT. Their first step was in seeing why and where their existing VAT tax management processes were insufficient.

Why Traditional VAT Management Is Broken

VAT compliance has become too complex to entrust to non-experts and non-purposed systems.

Traditional approaches to VAT management rely on people and systems. The problem is they are the wrong people in the wrong place, and the wrong systems.

Wrong people

A sizable organisation might have 10 or more professionals devoted to tax management. Reacting constantly to an ever-changing business environment, they are likely to be highly skilled at their professed job, but are probably not particularly adept at (or trained for) engaging in day-to-day accounting operations. On the other side of the organisation, there can be literally hundreds of operations people across accounting who are great at day-to-day operations, but who are not necessarily current on today's constantly changing tax requirements and not sufficiently trained to select the appropriate VAT as orders roll through.

Wrong systems

On the systems front, the most commonly used VAT tools are corporate ERP systems. Yet they are not designed to perform all VAT management requirements in an international environment. They simply lack the ability to process all the elements that go into VAT decisions. Plus it is an expensive and daunting proposition to keep them current with the world's fluid VAT laws. Hence, someone still needs to:

- Monitor all the relevant laws—which is time-intensive.
- Interpret those laws—which is skill-intensive.
- Configure and enhance the ERP system to ensure it is executing the laws correctly. This is a very complex and expensive undertaking.
- Select the proper tax code—which is a subjective procedure prone to human error and necessary because the ERP system cannot do that itself.

Wrong decisions

The “someone” who selects the tax code is usually an accounting clerk with insufficient knowledge or training. And if the tax code is open to question, that person will likely select a default code, which may be just as questionable or outright wrong. Multiply this scenario out globally across all a company’s operations, and you have a perfect deadly storm.

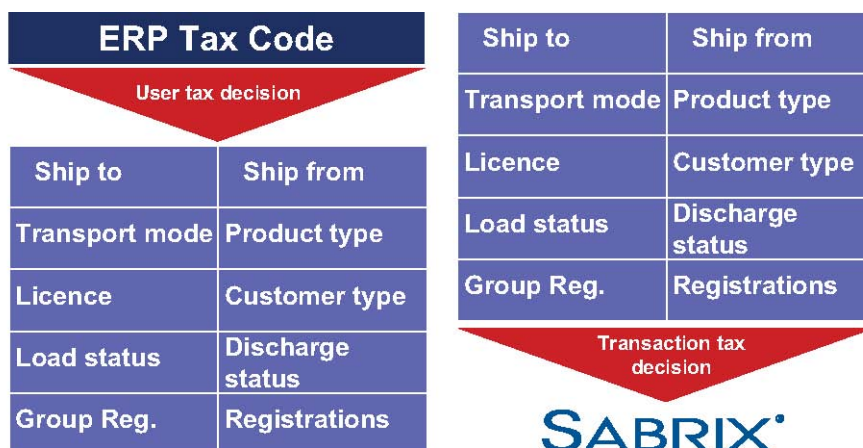


Figure A: Manual tax determination is based on a user selecting a tax code which is influenced by the transaction that takes place. Sabrix delivers greater accuracy as all elements related to that transaction are assessed to deliver an automated tax result.

Poor use of time

It is at the intersection of people and systems that VAT management begins to break down. You have dispersed groups of insufficiently trained personnel relying on insufficient systems, and a tax group unable to reach out effectively into all aspects of the business to manage the situation. How can you feasibly instruct an entire (and frequently changing) global finance organisation on the ins and outs of international tax laws and codes—and then monitor the application of those codes in something close to real time? The answer is, you cannot.

Instead, what happens is that highly skilled and expensive tax professionals end up spending as much as 90% of their time fighting fires and fixing problems on the backend. But what they are really paid to be doing is researching tax laws and planning tax strategies that can save the company millions.

Wrong way to manage change

Business is not static, yet current VAT management processes are neither flexible nor extensible enough to keep up with change. Wrong people in the wrong place, wrong systems, wrong uses of time... now add in new markets and tax jurisdictions, corporate mergers and acquisitions, and multiple ERP systems across various locations and the complexities, opportunities for error, and VAT overhead costs we have discussed thus far increase exponentially.

And just as businesses do not stand still, neither does VAT legislation. These laws are inherently complicated (each having its own calculation, terminology and cross-border rules) and intrinsically changeable. All laws, rulings and rates need to be assessed regularly (annually, at least) across all jurisdictions. At last count, that is 25 in the EU alone, and another 128 overseas. So, how do you:

- Monitor all these legislations, rulings and rate changes?
- Decide which legislation is applicable?
- Determine an acceptable margin for error for your interpretations?

Even EU member states themselves have difficulties with interpreting tax legislation, hence the large number of VAT cases before the European Court of Justice (ECJ). Then there are multi-level jurisdictions such as in Brazil and India, where there are city, state and federal levels of tax that have to be monitored and interpreted as well.

Poor model to centralise on

Companies often turn to centralisation to bring efficiency and control to business operations. Yet centralising responsibilities for tax only goes so far in addressing the challenges of global VAT management, and even centralisation is subject to business change. Should you shift around centralised responsibilities for tax as your business evolves, you risk losing valuable and hard-earned knowledge and face having to build it back up again somewhere else, thus negating many of the benefits gained from centralising operations in the first place. In any event, centralising without automating does not deliver the full measure of efficiencies and controls required for effective global tax management, nor does it start to address the other critical elements: ensured accuracy, transparency and easy auditability. In addition, the local country VAT managers still have the legal accountability for their VAT returns but without proper automation they often have no direct responsibility for the day to day tax decisions that are made by a shared service centre.

The New Wave: Consolidated Transaction Tax Management

Centralisation plus automation for efficient VAT compliance

The new paradigm in VAT management is to consolidate and automate in order to optimise both tax planning and execution, take complex tax decisions away from people and non-purpose built systems, and ensure compliance and auditability. Called Consolidated Transaction Tax Management, it comprises:

- 1 Consolidating VAT information across all pertinent enterprise systems onto a purpose-built tax management platform.
- 2 Automatically and correctly calculating tax across all relevant parameters.
- 3 Returning the results in near-real time to users and financial systems of record.
- 4 Automatically staying current with all applicable tax legislation and rate changes across all jurisdictions.

This paradigm effectively centralises and persists (i.e. permanently “institutionalises”) an organisation’s global tax knowledge and means for correct execution. The benefits of such an approach are far-reaching and include:

~ **A holistic view of tax information** – By consolidating all tax data onto a purpose-built platform, you are able to span all the diverse enterprise systems, disparate applications and disjointed functions that possess tax-related data, and in doing so gain a holistic view of your tax information.

~ **New accuracy** – With a purpose-built tax platform, reliance on default tax codes—that major drain on accuracy—is eliminated. Instead, day-to-day tax decisions can be made leveraging elements that are either invisible to ERP systems, or simply not considered for taxation. Such elements include multiple addresses to consider place of supply, buyer and seller locations to evaluate service transactions, responsibility to reverse charge, title transfer and authority-specific product taxability.

~ **Enhanced control** – Automating tax decisions not only eliminates opportunities for human error, but ensures that tax and business rules are applied consistently across your global operations.

~ **Greater efficiency** – Automation also ensures rapid calculation and implementation of tax decisions, as well as freedom for tax professionals to focus on tax planning and not firefighting. In essence, you eliminate the fires before they even begin to smolder. Consequently, there is no more time-consuming end-of-quarter rush to reconcile VAT—i.e. no more “starting with the tax return and working back” to get things right.

~ **End-to-end transparency** – With consolidation and automation comes end-to-end visibility into tax decisions and the tax management process. This includes visibility into all data and access to all documentation required to recover VAT, and also results in an audit trail for VAT compliance and compliance with regulatory mandates such as Basel II, Sarbanes-Oxley and International Accounting Standards (IAS). Also with transparency comes insight into the VAT management process that can be leveraged for continuous process improvement.

An ideal, not an idealised, approach

Consolidated Transaction Tax Management is more than just an idealised approach to administering VAT. It has been proven to be an ideal paradigm for enterprises of all sizes. Questions that need to be considered when implementing this new model include:

- ~ Will the deployed solution exert pressure or inflect changes on my existing accounting processes and systems?
- ~ Can the solution conform to all my particular business requirements?
- ~ How will the solution keep all of my operations current with tax updates worldwide? How trustworthy are the updates?
- ~ What degree of Information Technology (IT) involvement should I expect when deploying, updating and maintaining the solution?

These questions and others will be addressed in the next and final section of this paper.

The Sabrix Solution

Enterprise-class consolidated transaction tax management

Sabrix has developed a platform for centralised and automated VAT administration that delivers on the promises of Consolidated Transaction Tax Management. The Sabrix Solution is comprised of the:

- ~ Sabrix Application Suite software for VAT, sales, and use tax automation
- ~ Sabrix Tax Research, a service that delivers up-to-date and accurate tax rates and rules for more than 139 countries, including all EU member states, all members of the British Commonwealth, the United States, and countries with complex multi-level jurisdictions such as Brazil and India.

Proven across scores of Fortune-level global companies, the Sabrix Solution enables companies to close the gap between VAT planning and the effective and efficient worldwide execution of tax initiatives. Both planning and execution are improved, and tax initiatives are able to be implemented across the enterprise without having to make changes to existing enterprise systems or accounting processes.

Non-invasive data sourcing – reaches out to all tax-related enterprise systems

As finance and IT professionals understand, accessing legacy systems is not a light undertaking. Sabrix non-invasively integrates all relevant systems and sources of tax-related content using simple, pre-built connectors. Standard tax data elements and customer-specific transaction data elements are captured from such sources as material movement, warehouse, sales, purchasing, customer and finance systems and passed to Sabrix for tax determination and calculation.

On a technical level, Sabrix connectors utilise a simple XML interface over standard HTTP protocols. Sabrix fits seamlessly into the existing ERP business process and there is no need to engage with IT to configure tax law changes.

Automatic tax determination – based on all elements of the transaction

Given its cross-application access, Sabrix is able to determine tax based on all the elements of a given transaction. More than 250 elements can be considered, including address, customer, products, pricing, tax jurisdictions, customer/vendor taxability and much more. In contrast, an ERP system only considers the tax code that is passed manually to it for purchases or a highly complex hierarchy of tables and conditions is required to manage any VAT decision for a sale.

Fast, accurate results for each tax authority

Sabrix calculations average less than 50 milliseconds, and only the correct tax authority, rate and type is returned to the user. There are no default tax codes, no complex tables and conditions and no human guesswork to compromise accuracy. With results delivered almost instantaneously, there is no slowing down of workflows—in fact, workflows are accelerated as the need for human intervention is minimised.

Cross-border logic

The tax engine within Sabrix leverages sophisticated cross-border logic to achieve its accurate results for each tax authority—country, state, province, municipal, etc. All required accounting entries for VAT transactions are delivered, including:

- ~ Standard input and output VAT
- ~ Import VAT
- ~ Export and dispatch sales
- ~ Acquisitions
- ~ Reverse charges
- ~ Distance sales

EU capability

Complex European Commission cross-border rules and country-specific laws are also included in the logic, such as:

- ~ Zero-Rate & Exempt tax status
- ~ Point of Import taxation
- ~ Triangulation simplification
- ~ Distance sales calculation
- ~ Invoice messages in supported languages as identified in the European Invoicing Directive of December 2001
- ~ All EU-specific transaction types related to services including assembly & installed, customer location services, physical performance, transport services, intermediary services, and work on goods.
- ~ Islands & Territories outside the EU for VAT purposes such as the Channel Islands, Aland Islands & others

Institutionalised tax knowledge

To address the changeability inherent to taxes and corporate environments, the Sabrix solution encapsulates and perpetuates trusted, up-to-date tax knowledge. This knowledge is portable and leverageable across your global operations, no matter what organisational and operational changes take place. For example, should you move regional finance operations from Singapore and re-centralise them in Sydney, the local tax knowledge migrates seamlessly to the new location. Should you outsource your AR and AP functions, the knowledge encapsulated within Sabrix can be leveraged by your outsource service provider as well, to help ensure your VAT compliance.

Always current – Sabrix Global Tax Research

Comprised of dozens of researchers, CPAs and international tax experts, Sabrix Global Tax Research is a key element of the Sabrix Solution. Rather than you having to dedicate several employees to constantly comb through global tax legislation, Sabrix Global Tax Research personnel continually review laws and directives across all the world's tax authorities. In addition to rate changes, this service monitors and analyses rulings on:

- ~ Applicability of reverse charges
- ~ Inter-company transactions
- ~ Triangulation
- ~ Registration requirements
- ~ VAT Group Taxation
- ~ Title transfer/Inco term applicability
- ~ Import and export requirements
- ~ Product taxability (specially rated items)

Sabrix Global Tax Research possesses a perfect record for driving timely, accurate updates to the Sabrix solution. Monthly updates are made available automatically, reflecting changes in any areas that affect VAT calculations. And more frequent special updates are issued as merited.

Trusted

Importantly, tax results delivered by Sabrix have been validated by Big 4 Accounting firms as well as against tax results from major global companies and VAT managers worldwide.

Adaptable to your business requirements

The Sabrix Solution adapts flexibly to your business processes and models taxes per your particular requirements. For example, your basic transaction information can be enhanced by Sabrix prior to tax calculation by factoring in such information as:

- ~ Leasing rules
- ~ Services and education rules
- ~ Special rules pertaining to VAT recovery that are applicable to your business circumstances

Thus Sabrix thinks through your particular tax situations as you would think them through, provided you had the time to do so.

Audit comprehensively and conclusively

Compliance is an on-going process and a key aspect of the process is on-going audit-ability. Sabrix enables you to maintain a single source of VAT compliance information, with full audit trails for proving compliance. You are able to audit all the details related to each transaction, including all input elements, authority rate codes, rules, and system determination methods. Visibility into determination methods lets you see exactly what elements were evaluated and how product, customer and/ or location influenced the tax decision.

Conclusion

Regardless of whether you are buying or selling, there is no avoiding having to manage VAT and other forms of indirect tax. With VAT and corporate regulatory environments becoming increasingly complex, and with cross-border business the rule and not the exception for most companies, enterprises can no longer assume that their existing processes for managing VAT compliance will continue to work—if they indeed are working at all. They are simply too costly, too people-intensive and far too prone to risk.

Companies need to have confidence in the accuracy of VAT assessments and need to be able to prove compliance globally, no matter where they do business and how they do it. This means:

- ~ Taking unqualified people and non-purpose built systems out of the tax calculation equation.
 - ~ Instituting global VAT controls that are automatically enforceable across all parts of company.
 - ~ Being able to head off problems before they become problems—and before tax managers have to waste time getting involved.
 - ~ Automatically staying abreast of worldwide tax law changes.
 - Achieving transparency and auditability across VAT management processes.
- The Sabrix Solution enables you to take advantage of the new paradigm of Consolidated Transaction Tax Management—centralising and automating your management processes for efficient and auditable VAT compliance. With Sabrix, you gain:
- ~ A holistic view of your VAT information across all pertinent business systems and applications.
 - ~ Enhanced tax accuracy and control across all your operations.
 - ~ New freedom for your tax professionals to focus on high-value activities such as tax planning.
 - ~ End-to-end visibility into your tax decisions and tax management processes.

In eliminating information silos and process inefficiencies, Sabrix enables you to optimise your tax-related cash management and slash your costs of compliance on a global scale. By perpetuating trusted, up-to-date tax knowledge across your enterprise, Sabrix helps you manage the uncertainty and changeability that characterise today's tax and business environments. And by adapting to your business processes and requirements, Sabrix makes certain that your tax situations are thought through in the exact manner in which you would approach them.

With so many of today's corporate processes—customer relationship management, credit and collections, inventory management and control, etc.—now centralised and automated to great effect, VAT management is emerging as the new business process automation frontier. Relying on traditional methods to manage VAT compliance is only going to become more costly and more risky. In contrast, Sabrix provides the means for cost-effectively taking—and maintaining—control over those “invisible” taxes that account for 20% of your company's cash throughput, regardless of what the future holds.



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