Does new value just require new vision?

The better the question. The better the answer. The better the world works.
Managing indirect tax refunds
Welcome to Managing indirect tax refunds, our latest report on value-added tax (VAT), goods and services tax (GST) and customs and excise duties.

It examines the challenges that taxpayers face around the world in recovering foreign VAT/GST, managing domestic VAT/GST credits and obtaining customs and excise duty rebates. We also outline leading practices for avoiding and reducing excess indirect tax costs and for making successful claims.

You can download this report at ey.com/indirectrefunds to read offline or share with others in your organization. You will also find a wealth of related interactive content.

We hope that our comments, case studies and insights prove useful for your business.

About this report
Indirect taxes include broad-based taxes on consumption, such as VAT/GST and sales taxes; taxes on imports, such as customs duties; excise taxes; energy taxes; and environmental levies that apply to the trade or manufacture of a range of products, including alcohol, tobacco and fuel.

For most businesses, indirect taxes are intended to be “tax neutral” because they can be offset against other taxes in the supply chain or they can be included in the costs of production, distribution or sale. But in reality, these levies can create burdensome costs that must be actively managed. Unclaimed tax credits and missed or delayed refunds commonly cause negative cash flow and “tax leakage” that increase business costs and reduce profitability.

Complex local legislation, evolving business models and compliance obligations that vary widely by jurisdiction add to the complexity of making claims – and to the risk of disagreements about the validity of credits, rebates and refunds.

To manage these costs effectively, you need to take action across the organization to gain visibility into the indirect taxes you incur and clarity about how they can be refunded or offset. Ask yourself: do you know how much duty is trapped in your supply chain? Do you know how much VAT/GST is sitting on the balance sheet? If you are expecting a refund, how realistic is that receivable? Will you receive it in full? What will it cost to claim and how long will you wait for reimbursement? Can you afford to claim? Can you afford not to? Are you missing opportunities to reduce negative balances, obtain rebates and avoid absolute costs?

The answers will help you to design an effective refund strategy that increases recovery, improves cash flow and reduces costs and risks.

Building a better working world
At EY, we help build a better working world by advising our clients on strategically meeting their tax obligations and resolving tax controversy. We also foster an open dialogue with tax administrators, government officials and other stakeholders about tax issues, the impact of policy decisions and the contributions that companies and individuals make to society by paying the correct amount of a variety of taxes. And, where a resolution cannot be reached by other means, we can assist in developing and executing a litigation strategy.

To learn more about how you can manage indirect taxes, please contact me or one of the EY Indirect Tax professionals listed in this report.

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Executive summary

Managing cross-border VAT/GST refunds
Recovering foreign VAT/GST and reducing excess foreign VAT/GST credits are crucial parts of an effective indirect tax strategy. However, recovering foreign VAT/GST is difficult or even impossible in many countries. Even where refunds apply, long delays are common and claims may be subject to intense audit scrutiny that can tie up corporate resources. As a result, unclaimed or irrecoverable foreign VAT/GST is a common cause of excess indirect tax credits for many global businesses, leading to negative cash flow and absolute costs. Not all nonresident businesses qualify for direct VAT/GST refunds.

Time to review your foreign VAT/GST refund strategy?
Developing an effective strategy for dealing with or mitigating foreign VAT/GST can improve recovery rates and reduce associated costs. However, many organizations assume that the costs and difficulties of recovering foreign taxes will outweigh the benefits. Now may be the time to review and challenge that assumption. Changes in tax legislation and advances in technology mean that fact patterns, assumptions and decisions made even just a few years ago can be quickly out of date.

Claiming direct refunds of foreign VAT/GST
A successful foreign VAT/GST refund claim depends on complying with all of the conditions imposed by tax administrations – in every jurisdiction where you want to claim. Understanding the detailed rules and thoroughly applying them can improve your chances of success in reclaiming foreign VAT/GST on your business expenses. Accurate documentation, in particular, is key. Planning ahead and complying with how and when you make your claims and understanding the reciprocity rules are also crucial factors.

Alternatives for recovering foreign VAT/GST
As few countries make direct VAT/GST refunds to nonresident claimants, global businesses must explore other options to reduce and avoid irrecoverable costs and long delays in receiving reimbursement, such as registering for VAT/GST locally or rerouting supplies. Identifying the key jurisdictions for your business where VAT/GST may be refunded, or where incurring tax should be avoided is a vital aspect of planning cross-border activities.
Managing domestic VAT/GST credits

Input tax credits are an inevitable part of the VAT/GST system. They arise when the VAT/GST paid on a VAT/GST payer’s purchases (input tax) in a tax period is greater than the VAT/GST charged on its sales (output tax) in that period. Carrying forward excess input tax is one of the biggest cash flow concerns for VAT/GST payers.

Accounting for input VAT/GST correctly and actively managing VAT/GST credits are essential aspects of any effective indirect tax strategy. These may seem like straightforward tasks, but detailed domestic rules on VAT/GST recovery and differences in how countries handle refunds can complicate the picture, especially for global companies.

VAT/GST – never a cost to business?

As a flow-through tax borne by final consumers, VAT/GST should not be a cost to businesses, but that is not always the case – most VAT/GST payers encounter “sticking tax,” i.e., irrecoverable VAT/GST incurred on legitimate business expenditure. Equally important, for businesses that frequently accumulate excess input tax credits, the impact of negative VAT/GST cash flow on working capital may be significant.

Recovering VAT/GST on business costs

Most tax administrations apply strict rules to the recovery of input tax, but the rules for VAT/GST recovery are not harmonized. Making a successful refund claim depends on knowing and applying the detailed rules in every country where you operate or incur costs.

Where do credits accumulate?

Excess input tax is a common cause of negative cash flow for VAT/GST payers. Different countries treat excess input tax credits in different ways. The excess may, for example, be refunded, carried forward or used to offset other taxes. These different approaches can have significantly different impacts on affected businesses and should be factored into strategic decisions about managing VAT/GST costs and cash flow.

In some jurisdictions, receivables may be outstanding for months or even years. Understanding how and where credits arise and taking action to deal with excessive delays and “crunch points” can greatly improve management of working capital.

Business start-up costs

Setting up a new company, starting a new business venture or entering a new market is a crucial stage in the life of any business – when effective cash management is vital to success. These phases can also be common sources of excess input tax credits because most new businesses pay VAT/GST on setup costs before they start to trade and charge VAT/GST on their sales. However, only 55 of 120 countries refund input VAT/GST incurred on pre-registration costs. Engaging in strategic planning and taking action can greatly improve VAT/GST cash flow and reduce additional VAT/GST costs. Exploring alternatives may help new businesses to avoid incurring irrecoverable VAT/GST on setup costs or to greatly reduce the financial impact of long delays.
Executive summary continued

Avoiding or reducing domestic VAT/GST credits
Managing VAT/GST refunds and credits involves looking critically at the VAT/GST you pay and identifying ways to reduce or avoid accumulating sticking tax and excess credits. One of the most effective ways to manage refunds is to avoid incurring excess input tax. Effective strategies to mitigate excess input tax may include identifying opportunities to buy goods and services VAT/GST-free (e.g., through VAT/GST grouping), to accelerate refunds (e.g., as a frequent exporter) or to use reverse charge accounting (e.g., by purchasing services cross-border).

Managing customs duty refund opportunities
More than ever, effectively managing global trade requirements and costs is crucial to obtaining and maintaining a competitive advantage.

Free trade agreements
Effectively identifying and using free trade agreements (FTAs) can significantly reduce — or even eliminate — duty costs. With over 400 trade agreements in force, optimizing utilization has become a primary focus of many importers. While the fullest benefit of FTAs is achieved when claims for preferential treatment are made at the time of entry, importers should remember that many agreements do permit refunds for a certain time after entry.

However, in today’s environment, the FTA climate is changing. This is illustrated by the US withdrawing from the Trans-Pacific Partnership and the potential renegotiation of the North American Free Trade Agreement (NAFTA). Such moves may signal a shift away from large multilateral agreements to more bilateral agreements. Companies should be mindful of how potential changes might affect their overall duty impact.

Duty drawback
Duty drawback is a refund mechanism used globally, typically to promote job creation for manufacturing and export activity. The specific drawback opportunities and requirements vary by jurisdiction. Generally, duty drawback programs permit refunds of customs duties, fees and taxes paid in connection with the importation of products if those goods (or like-kind goods) are later exported or destroyed.

Classification
Correct classification of goods is necessary to properly assess customs duties. In most countries, incorrect classification can result not only in penalties for the importer but also in overpayment or underpayment of duties. With average rates of 2% to 3%, duties are not an insignificant cost and they can directly affect a company’s bottom line. Compliance objectives aside, correcting classification errors can be worthwhile, particularly in jurisdictions where an importer can obtain a refund for overpaid duties.

Valuation
Refund opportunities may be available for companies importing from related parties where transfer pricing adjustments occur. These adjustments may change product pricing. A downward adjustment may result in a duty refund, while an upward adjustment will require additional payment of duties.
Managing excise duty refund opportunities

Excise taxes apply to specific goods and services, and they are often seen as an inevitable cost of doing business in industries that produce and sell alcohol, tobacco, fossil fuels and snack foods. But these taxes apply to different products in different countries, sometimes at different stages of the supply chain; opportunities to reduce the impact of excise duties also vary between countries. Managing excise taxes and understanding opportunities to mitigate their impact are crucial for all businesses operating in affected industries.

Indirect tax refunds – the future is coming

Nowadays, any discussion on the future of indirect taxes is almost bound to include the terms “robotic process automation” (RPA), “artificial intelligence” (IA), “the Internet of Things” (IoT), “machine learning” and “blockchain.” Relatively obscure concepts only a few years ago, these technologies are increasingly providing solutions to a range of challenges facing governments and global businesses. They have the potential to streamline and accelerate business processes, increase cybersecurity and reduce or eliminate the roles of trusted intermediaries and centralized authorities.

From review to renew: adopting a strategy for indirect tax refunds

Actively managing indirect tax costs should be a central part of any corporation’s taxation strategy. Even if your business chooses not to claim VAT/GST refunds or to reduce customs duty costs, those decisions should be based on deliberation and knowledge of your options and the likely outcomes. You need to identify the indirect costs you incur and related financing, your options for reducing or avoiding excess costs and apply an effective process for recovering or mitigating them.

And this process should be kept under constant review.

Many of the methods for driving indirect taxes out of the business and improving working capital are not new, but change is constant: the approaches and decisions of today (may no longer be appropriate tomorrow based on developments in tax, business and technology. Taking a fresh look at how you deal with the fundamentals can bring surprising rewards.

The OECD’s International VAT/GST Guidelines set standards on VAT neutrality and on destination-based taxation of cross-border sales of services to businesses (B2B) and final consumers (B2C). Read more at: www.oecd.org/ctp/consumption
Managing cross-border VAT/GST refunds
Recovering foreign value-added tax (VAT) and goods and services tax (GST) and reducing excess foreign VAT/GST credits are crucial parts of an effective indirect tax strategy.

VAT/GST recovery by nonresident businesses is difficult or even impossible in many countries. Even where refunds apply, long delays are common. As a result, unclaimed or irrecoverable foreign VAT/GST is a common cause of excess indirect tax credits, leading to negative cash flow and absolute costs.
Why is foreign VAT/GST a common cost of business?

VAT/GST applies worldwide: most countries now impose a VAT/GST or similar sales tax. As business has become increasingly international, more businesses are paying foreign VAT/GST charges in their everyday activities by having executives travel, by attending or hosting international meetings and conferences, and by engaging in global trade.

Most global businesses incur VAT/GST in countries where they are not established – for example, on trade fairs and conferences, filming on location, meals and accommodations, travel, transportation and fuel, business entertainment, marketing and advertising, professional services, telecommunications, printed materials and stationery, and training.

Sticking tax: irrecoverable VAT/GST is often referred to as “sticking tax” because it becomes part of the cost of goods and services within the supply chain. Common reasons for “sticking tax” include:

- Countries do not refund VAT/GST to nonresidents.
- Businesses do not track and identify foreign VAT/GST.
- Businesses do not claim foreign VAT/GST refunds.
- Expenses are not supported by suitable detail and documentation.
- Expenditures do not qualify for input tax recovery.
- Refund claims are rejected for formal reasons.
- Refund claims fail local tax audits.

Input tax recovery by VAT/GST taxpayers is a crucial feature of all classic VAT/GST systems: VAT/GST taxpayers have the right to recover input tax paid on legitimate business expenses and receive refunds or credits for excess input tax. That way, VAT/GST “flows” through the system, and the burden of taxation falls on final consumers, not on businesses within the supply chain. This offset system usually works well for domestic taxpayers but not so effectively for nonresident businesses. In many cases, foreign VAT/GST is not recovered, and it becomes a cost of doing business.

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Common expenses that may attract foreign VAT/GST

- Hotel, restaurant and entertainment costs
- Meeting rooms, equipment hire, catering costs and business support services for conferences and events
- Printing
- Advertising and promotion in the territory
- Telecommunications
- Technology purchases
- Car hire, gasoline and vehicle maintenance
- Legal and professional services
- Transportation, warehousing and processing of goods
- Goods for resale or onward supply
- Setup costs for a local office, shop or warehouse
**Tax administrations:** because the tax is collected and remitted by businesses, the VAT/GST system can be vulnerable to fraud and manipulation by dishonest traders. Tax administrations may be concerned about their ability to verify and audit nonresidents’ refund claims effectively. Some countries may also be concerned about the costs and resources associated with establishing and administering refund schemes. In most cases, these concerns have been overcome only where there are clear mutual refund protocols (such as those in the EU).

**Can this situation continue?**

As business becomes increasingly global, more taxpayers are likely to incur VAT/GST costs in foreign jurisdictions. The issue of “stuck” foreign VAT/GST resulting from difficult administrative procedures and a lack of mutual refunds may become a higher priority for global businesses, and they may seek to influence tax policy in this area.

The Organisation for Economic Co-operation and Development (OECD), for example, has already indicated in its *International VAT/GST Guidelines* that countries should take steps to keep nonresidents from incurring input tax costs. Tax administrations may also be willing to change their stance as the increased use of technology, data analytics and e-audit techniques improves administrative processes and eases their concerns about the costs and risks associated with granting refunds to nonresidents.

**Footnotes:**

Should you review your strategy?

If you have not reviewed your foreign VAT/GST recovery strategy in the past two years, now may be the time to do so. Facts and assumptions can be quickly out of date.

Many businesses assume that it is not worth the time and effort to identify and claim foreign VAT/GST, or that it’s best to outsource this activity. But how can you make those decisions if you don’t have the full picture?

As business becomes more global, you may now be paying VAT/GST in countries where you did not previously operate or where tax did not apply. Executive travel is increasing, as are international meetings and events. VAT/GST rules are also changing as more countries introduce these taxes or apply them differently. Your biggest overseas indirect tax costs may be related to taxes “trapped” in your overseas supply chains, such as goods sent for processing, or assets imported for temporary use or made available to customers.

The foreign VAT/GST you pay may be recoverable – subject to local rules. Knowing and applying the detailed input tax rules in multiple jurisdictions can be difficult and time-consuming; many claimants outsource their nonresident VAT/GST refund claims to third parties that specialize in identifying eligible costs and preparing and pursuing these claims. This can be a cost-effective alternative to using in-house resources. However, it is not always the best option.

In recent years, technology such as data analytics and invoice scanning has opened up new opportunities to identify and quantify foreign VAT/GST more easily and cheaply than ever. Decisions about the costs and benefits of claiming may no longer be valid, and even if you already recover foreign VAT/GST, you may not be doing so in the best or most cost-effective way.

Developing a strategy

Businesses can address the issue of irrecoverable foreign VAT/GST. Developing an effective strategy can improve recovery rates and reduce associated costs.

Key actions include:

- Improving business processes to identify, quantify and support claims
- Improving the quality and effectiveness of refund claims
- Adopting alternative strategies to identify and pursue successful claims and to avoid, reduce or recover foreign VAT/GST

Managing cross-border VAT/GST refunds

Time to review your foreign VAT/GST refund strategy?

Should you review your strategy?

Developing a strategy

Should you outsource?
Key considerations for managing foreign VAT/GST

As more companies pay foreign VAT/GST, they are also seeking to recover, reduce or offset the cost. What are the crucial questions to consider?

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<td>The countries that refund VAT/GST</td>
<td>Do the countries where you incur VAT/GST refund it?</td>
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<tr>
<td></td>
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<td>Does your country qualify?</td>
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<td>Do different rules apply in different countries?</td>
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<td></td>
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<td>Do you have alternatives?</td>
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<td></td>
<td>The reasons, sources and types of expenditures you have</td>
<td>Which amounts and general ledger accounts are most significant for your business?</td>
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<tr>
<td></td>
<td></td>
<td>Is this VAT/GST recoverable?</td>
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<td></td>
<td>Do different rules apply in different countries?</td>
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<tr>
<td></td>
<td>What the claims process entails and any gaps between what you have and what you need for the countries where you want to claim</td>
<td>Do you have suitable processes?</td>
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<tr>
<td></td>
<td></td>
<td>Do you have the documents, forms and supporting material you need?</td>
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<td>Are you on time?</td>
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<td></td>
<td></td>
<td>Do you have the proofs of taxable status you need?</td>
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<tr>
<td>Who should do it?</td>
<td>Your options and resources</td>
<td>Do you have the necessary knowledge?</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Do you have suitable staff?</td>
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<tr>
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<td></td>
<td>Should you insource or outsource? Could you use a local VAT/GST registration?</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Will you need a local fiscal representative?</td>
</tr>
<tr>
<td>Is it worth it?</td>
<td>The costs of claiming compared with the likely benefits</td>
<td>What is it likely to cost in-house and outsourced?</td>
</tr>
<tr>
<td></td>
<td></td>
<td>What are the likely costs of alternatives?</td>
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<tr>
<td></td>
<td></td>
<td>How long is it likely to take for reimbursement?</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Will your claim stand up to an audit?</td>
</tr>
<tr>
<td>Can you improve for the future?</td>
<td>Reasons that claims have been rejected or not pursued in the past</td>
<td>Should you change your processes?</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Can you improve your documentation?</td>
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<tr>
<td></td>
<td></td>
<td>Has your structure changed?</td>
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<tr>
<td></td>
<td></td>
<td>Have your activities changed?</td>
</tr>
</tbody>
</table>
Should you outsource?

There are two key factors in deciding whether to process refund claims in-house or outsource to a service provider:

- Technical knowledge
- Resources (time and people)

Technical knowledge

As described in this article, the rules for claiming a cross-border refund of VAT/GST may appear to be straightforward, but the reality is they become detailed and even more complex when you get into the process. For example, while cross-border EU-to-EU refund claims are made via a dedicated portal in the EU country where the claimant is registered, there is no consistency of approach between countries. Some countries require manual input into the portal; others allow the uploading of a file; and some require XML files, a CSV file or even a TXT file. Often, only electronic copies of invoices are required where the amount is below a certain threshold or related to a specific type of expense. Even then, the size of the file is limited. For non-EU-to-EU claims, the process involves manually filing forms to which schedules of the invoices related to the claim need to be attached, with some countries allowing e-filing rather than the mailing of claims.

The rules on whether the VAT on an expense is claimable are not consistent across countries even within the EU. Most EU countries allow the refund of VAT on hotel expenses but some do not, and some restrict the claim to accommodation only. There is often another practical problem with hotel expenses in that the invoice should be addressed to the business but often is addressed only to the employee with no address or even his or her home address. There is also the issue over what countries will accept as evidence of entitlement to refund, especially where invoices are issued electronically or a country allows paper invoices to be stored electronically but requires original invoices.

Resources

Making cross-border refund claims is not a day-to-day VAT/GST compliance process but one that usually occurs annually or quarterly and sometimes close to the deadline to filing the claims. That, together with the knowledge required to process the claims, leads to the question of whether an in-house resource is capable of processing the claims, let alone actually having the resource with the time to do it, especially if resources within the tax or finance departments are limited. Most times, it is easier to use a third-party that has the resources and knowledge to process the claims efficiently and cost-effectively and monitor the claims. The cost effectiveness lies in the fee structure. Contingent fee arrangements are very common as opposed to a structure based on a fixed fee for known time elements and a variable for unknown. The former seems a cost-effective method, but it can lead to underclaims where the contingent fee results in focusing on the larger costs because these are in proportion less expensive to process. The latter structure has advantages, especially when it is taken into account the data analytics that can be performed to enhance business decisions about which expenses to process in the overall claim, and optical character recognition (OCR) software now aids the efficient review of invoices online. In addition, the data analytics can be aligned to other business needs; for example, verifying that employees in their business travels are not causing a permanent establishment or personal income tax exposure.
Claiming direct refunds of foreign VAT/GST

Will your refund claim succeed?

A successful foreign VAT/GST refund claim depends on complying with all conditions imposed by tax administrations – in every jurisdiction where you want to claim. Understanding the detailed rules and thoroughly applying them can improve your chances of success in reclaiming foreign VAT/GST on your business expenses.

Although there are mechanisms for VAT/GST recovery, it may be difficult for foreign businesses to fulfill the requirements in practice. Not every country allows nonresidents to recover VAT/GST or to recover VAT/GST on all expenditures. In addition, tax authorities apply strict criteria before they will authorize a repayment. Barriers to recovering foreign VAT/GST include a lack of understanding of the detailed indirect tax rules in different jurisdictions, difficult administrative procedures, language barriers, insufficient or incorrect documentation and missed deadlines.

Key compliance factors:

- **Refunds apply**: as of 1 January 2017, only 38 countries listed in the *Worldwide VAT, GST and Sales Tax Guide* provide direct VAT/GST refunds to nonresidents.
- **Eligible expenses**: only VAT/GST paid on business-related expenses can be reclaimed.
- **Eligible claimant**: only VAT/GST paid on business-related expenses by eligible claimants can be reclaimed directly.
- **Reciprocity**: some countries apply strict reciprocity rules that exclude claimants from jurisdictions that do not allow similar refunds of any turnover taxes they levy.
- **Formal compliance**: most countries impose strict conditions about the forms and documents that must be submitted and the time limits that must be respected.

Where can you claim?

Is your input VAT/GST recoverable?

Does your business qualify?

Does your claim comply?
Jurisdictions that refund VAT/GST to nonresidents

- Direct refund for nonresidents
- No direct refunds for nonresidents
- Gulf Cooperation Council – to be determined
Where can you claim?

Few countries outside Europe refund VAT/GST directly to nonresident businesses. Global businesses must consider a range of strategies to avoid, reduce or recover foreign VAT/GST. The *Worldwide VAT, GST and Sales Tax Guide* sets out rules in 120 countries.

**Direct VAT/GST refunds:** as of 1 January 2017, only 38 countries listed in the guide refund input VAT/GST directly to nonresident businesses that are not registered for VAT/GST in that country.

**Other VAT/GST refunds to nonresidents:** as of 1 January 2017 more than 20 countries that, while not providing direct refunds, do allow non-established businesses to register for VAT/GST and recover input tax, or allow recovery of VAT/GST by nonresidents in specific cases (such as for exports). More countries worldwide may also allow these options for nonresidents, in practice.

**The regional picture**

Europe dominates the VAT/GST refund landscape. This focus arises from mutual recovery procedures established among EU Member States and with other countries in Europe that have adopted similar VAT systems. However, as business becomes more global, increasing pressure may be brought to bear on countries that do not offer direct refunds or alternatives to mitigate “sticking tax” (such as local registration or zero-rating).

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**Countries offering direct refunds to nonresidents**

- VAT/GST: 38 countries out of 120 offer direct refunds to nonresidents.
Direct VAT/GST refunds to nonresidents: of the countries that refund VAT/GST directly to nonresident businesses, 28 are EU Member States and a further 7 are also in Europe. In the rest of the world, foreign VAT/GST is generally not refunded, or refunds are limited to classes of expenditures or classes of taxpayers, such as nonresidents who register for VAT/GST as local taxpayers.

This European focus may shift a little with the introduction of GST in India (expected on 1 July 2017) and of VAT in Gulf Cooperation Council states (expected on 1 January 2018), as these new countries may provide for refunds to nonresidents (especially businesses located in countries that offer refunds on a reciprocal basis). However, the rules in these countries are not yet clear.

Other VAT/GST refunds to nonresidents: the regional picture also looks slightly different if you consider countries that refund VAT/GST in other ways. Of countries that explicitly state in the Worldwide VAT, GST and Sales Tax Guide that other refund mechanisms are possible, 5 are in Europe, 10 are in Asia or Asia-Pacific, 7 are in Africa, 3 are in the Middle East and 7 are in the Americas. More countries worldwide may also allow these options for nonresidents, in practice.
## Direct VAT/GST refunds to nonresident businesses

### Refunds for nonresidents

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<thead>
<tr>
<th>Country</th>
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<tbody>
<tr>
<td>Austria</td>
<td>Germany</td>
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<td>Bulgaria</td>
<td>Hungary</td>
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<td>South Korea</td>
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<td>Croatia</td>
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<td>Cyprus</td>
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<td>The Netherlands</td>
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<td>Czech Republic</td>
<td>Isle Of Man</td>
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<td>Switzerland</td>
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<tr>
<td>Denmark</td>
<td>Italy</td>
<td>Poland</td>
<td>UK</td>
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<tr>
<td>Estonia</td>
<td>Jersey, Channel Islands</td>
<td>Portugal</td>
<td>Zimbabwe</td>
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<tr>
<td>Finland</td>
<td>Latvia</td>
<td>Romania</td>
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<tr>
<td>France</td>
<td>Lebanon</td>
<td>Serbia</td>
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</table>

### No refunds for nonresidents

<table>
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<tr>
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<td>Argentina</td>
<td>Costa Rica</td>
<td>Malaysia</td>
<td>Philippines</td>
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<td>Armenia</td>
<td>Curaçao</td>
<td>Maldives</td>
<td>Puerto Rico</td>
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<tr>
<td>Aruba</td>
<td>Dominican Republic</td>
<td>Mauritius</td>
<td>Rwanda</td>
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<td>Azerbaijan</td>
<td>Ecuador</td>
<td>Moldova</td>
<td>Seychelles</td>
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<tr>
<td>Bahamas</td>
<td>Egypt</td>
<td>Mongolia</td>
<td>Sint Maarten</td>
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<tr>
<td>Barbados</td>
<td>El Salvador</td>
<td>Myanmar</td>
<td>Suriname</td>
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<tr>
<td>Bolivia</td>
<td>Guatemala</td>
<td>Nicaragua</td>
<td>Ukraine</td>
</tr>
<tr>
<td>Bonaire, Sint Eustatius and Saba</td>
<td>India (changes expected July 2017)</td>
<td>Nigeria</td>
<td>US</td>
</tr>
<tr>
<td>Brazil</td>
<td>Indonesia</td>
<td>Pakistan</td>
<td>Uruguay</td>
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<tr>
<td>Chile</td>
<td>Kosovo</td>
<td>Panama</td>
<td>Venezuela</td>
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</tbody>
</table>

**Gulf Cooperation Council (rules to be determined by 1 January 2018)**

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<thead>
<tr>
<th>Country</th>
<th>Country</th>
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<tbody>
<tr>
<td>Bahrain</td>
<td>Oman</td>
<td>Saudi Arabia</td>
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<tr>
<td>Kuwait</td>
<td>Qatar</td>
<td>United Arab Emirates</td>
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<tr>
<td>Country</td>
<td>Description</td>
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<td></td>
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</tr>
<tr>
<td>Australia</td>
<td>Nonresidents may register for GST and recover input tax as domestic taxpayers.</td>
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<tr>
<td>Belarus</td>
<td>Foreign entities with a permanent establishment in Belarus may register for VAT to recover input tax.</td>
<td></td>
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<tr>
<td>Botswana</td>
<td>VAT refunds apply to goods exported as &quot;accompanied baggage&quot; if the value exceeds BWP500.</td>
<td></td>
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<tr>
<td>Canada</td>
<td>GST/HST refunded to nonresidents on short-term accommodations and some conventions if at least 75% of the attendees are nonresidents.</td>
<td></td>
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<tr>
<td>Colombia</td>
<td>No direct refunds for businesses – refunds are available for diplomatic missions, etc.</td>
<td></td>
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<tr>
<td>Georgia</td>
<td>Nonresidents may obtain refunds on exported goods if the price exceeds GEL200 exclusive of VAT per receipt. The vendor must issue a special tax receipt.</td>
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<tr>
<td>Ghana</td>
<td>Nonresidents may recover VAT for exported goods.</td>
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<tr>
<td>Honduras</td>
<td>Refunds are available for diplomatic missions, etc.</td>
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</tr>
<tr>
<td>Israel</td>
<td>Many supplies made in Israel may be zero-rated if provided to nonresidents (e.g., hotel accommodations).</td>
<td></td>
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<tr>
<td>Japan</td>
<td>Nonresidents may recover consumption tax by appointing a tax representative and electing to be treated as a domestic taxable business.</td>
<td></td>
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<tr>
<td>Jordan</td>
<td>Nonresidents may recover tax paid on exported goods if the amount is greater than JOD50 but less than JOD500. Refunds also apply to diplomatic missions, etc.</td>
<td></td>
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<tr>
<td>Kazakhstan</td>
<td>Refunds are available for diplomatic missions, etc.</td>
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<tr>
<td>Kenya</td>
<td>Nonresidents may register for VAT and recover VAT as domestic taxpayers.</td>
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<tr>
<td>Mexico</td>
<td>Nonresidents may register for VAT and recover VAT as domestic taxpayers.</td>
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<tr>
<td>Morocco</td>
<td>Nonresidents may register for VAT and recover VAT as domestic taxpayers.</td>
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<tr>
<td>Namibia</td>
<td>Limited to exported goods.</td>
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<tr>
<td>New Zealand</td>
<td>Enhanced registration is permitted for nonresidents. The nonresident must be a taxable person in its country of residence. Minimum claim NZS500. Refunds may be delayed for up to 90 days.</td>
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<tr>
<td>Papua New Guinea</td>
<td>Nonresidents may register for VAT and recover VAT as domestic taxpayers.</td>
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<tr>
<td>Peru</td>
<td>Nonresidents may register for VAT and recover VAT as domestic taxpayers.</td>
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<tr>
<td>Russia</td>
<td>Nonresidents may register for VAT and recover VAT as domestic taxpayers.</td>
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<tr>
<td>Saint Lucia</td>
<td>Nonresidents may register for VAT and recover VAT as domestic taxpayers.</td>
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<tr>
<td>Singapore</td>
<td>Nonresidents may register for VAT and recover VAT as domestic taxpayers.</td>
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<tr>
<td>South Africa</td>
<td>Refunds are generally limited to exported goods. VAT registration may be obligatory for some nonresident service providers, which gives the right to VAT recovery, as domestic taxpayers.</td>
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<tr>
<td>Taiwan</td>
<td>Refunds are limited to participation in trade events and exhibitions. Amount must exceed TWS5,000.</td>
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<tr>
<td>Tanzania</td>
<td>Nonresidents may register for VAT and recover VAT as domestic taxpayers.</td>
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<tr>
<td>Thailand</td>
<td>Nonresidents may register for VAT and recover VAT as domestic taxpayers.</td>
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<tr>
<td>Trinidad and Tobago</td>
<td>Nonresidents may register for VAT and recover VAT as domestic taxpayers.</td>
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<tr>
<td>Tunisia</td>
<td>Nonresidents may register for VAT and recover VAT as domestic taxpayers.</td>
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<tr>
<td>Turkey</td>
<td>Limited to international transporters for fuel and repairs and VAT related to trade fairs and exhibitions.</td>
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<tr>
<td>Uganda</td>
<td>Nonresidents may recover VAT if they have a permanent establishment and are registered for VAT.</td>
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<tr>
<td>Vietnam</td>
<td>Nonresidents may recover VAT if they have a permanent establishment and they adopt the VAS/Hybrid Method. Refunds may also be granted to taxpayers eligible for diplomatic immunity and on retail exports.</td>
<td></td>
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</tr>
<tr>
<td>Zambia</td>
<td>Limited to commercial exports of goods made by foreign passport holders supplied by participating suppliers.</td>
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</tbody>
</table>
Is your input VAT/GST recoverable?

The rules for input tax recovery are generally the same for nonresident and resident businesses. Is the foreign VAT/GST you incur recoverable? Do you know the local rules in every country where you operate?

Claimants must be aware of the detailed VAT/GST recovery rules that apply in every country where they want to claim input tax. Knowing the rules in one country may not help in another. The laws can vary widely among jurisdictions, even among countries in the same trading bloc, especially with common business travel expenses items, such as charges for hotel accommodations, restaurants, taxis and car hire.

In addition, some countries restrict recovery of VAT/GST by nonresidents to certain types of expenditures (such as VAT/GST paid on exported goods or related to attending international trade fairs) or to certain claimants (e.g., diplomatic missions).

Does your business qualify?

Not all nonresident businesses qualify for direct VAT/GST refunds. Many countries apply strict reciprocity principles.

The eligibility rules vary by country. Detailed conditions are set out in the relevant chapters of the *Worldwide VAT, GST and Sales Tax Guide*.
Some common conditions for direct refunds of foreign VAT/GST include:

- **Taxable person**: the claimant must be a taxable person in its country of residence. A taxable person may include government bodies or local authorities as well as businesses such as corporations, partnerships and sole entrepreneurs. In the EU, claimants from other Member States qualify for taxable status. Non-EU claimants must carry out activities that would make them eligible to be taxable persons if their activities were conducted in the EU. Claimants may need to provide documentation to prove their eligibility.

- **No local presence**: most countries require the claimant not to have a fixed establishment, permanent establishment or place of business from which business transactions are effected. If the claimant has a local presence, it may be required or be eligible to register for VAT/GST as a domestic taxpayer.

- **No local supplies**: most countries require that the claimant must not supply any goods or services in the country where the VAT/GST refund is requested. However, some activities may be permitted. Common exceptions include transport and transport-related services and supplies of goods and services if the local customer applies the reverse charge. In the EU, suppliers of digital services that use the Mini One Stop Shop (MOSS) simplification scheme are also eligible for direct refunds.

**Insight**

Film or broadcaster businesses that are filming on location for a long period of time, or have set up a hub for filming at a sporting event, may want to confirm with the local tax authorities that this does not give them a corporate tax permanent establishment or a VAT fixed establishment.

**Insight**

Conferences or trade fairs attended by several people from different countries across a multinational corporate group commonly use a local company to pay all the local costs (e.g., accommodations, admissions and transport) and then recharges the costs. In the EU, this practice can result in a liability to account for VAT under the Tour Operators Margin Scheme for the local company.
Reciprocity

Mutual refund arrangements are a common condition of eligibility for direct refunds. If your business is resident in a country that refunds VAT/GST to nonresidents, you have a far greater chance of success in claiming refunds in other countries.

According to the Worldwide VAT, GST and Sales Tax Guide, of the 38 countries that offer direct VAT/GST refunds to nonresidents, 16 do not exclude claimants based on their country of residence, while 22 apply some form of reciprocity. Broadly, reciprocity requires the claimant’s country to refund VAT/GST to claimants from the country where the claim is made.

EU residents: all EU Member States must automatically refund VAT to eligible claimants from other EU Member States. Businesses resident in EU Member States also qualify for refunds in a number of non-EU jurisdictions (such as Iceland, Norway and Switzerland).

Non-EU residents: the mutual refund picture is far patchier for non-EU residents. As of 1 January 2017, 12 EU Member States do not exclude claimants from any countries from direct VAT refunds (provided that the claimant meets the other eligibility criteria). However, 16 EU Member States apply reciprocity principles to non-EU claimants.

Different EU Member States interpret reciprocity in different ways, and each has its own conditions. Claimants from European countries with similar VAT systems, such as Iceland, Norway and Switzerland, commonly qualify for refunds. Claimants from other countries, such as the US, may be excluded by some countries (such as Italy or Spain) but eligible in others (such as Germany).

Non-EU countries that grant direct refunds may also apply reciprocity conditions. Some non-EU countries (such as Iceland and Norway) do not exclude claimants from any other countries, while others (such as Lebanon and Switzerland) may apply reciprocity or other conditions.

Footnotes:

EU Member States without reciprocity conditions

12 VAT/GST out of 28
no reciprocity conditions
Reciprocity in the EU

[Map showing reciprocity in the EU with countries marked as having no reciprocity conditions or reciprocity conditions.]

- No reciprocity conditions
- Reciprocity conditions

Managing indirect tax refunds
### Direct VAT/GST refunds to nonresident businesses: reciprocity conditions

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<td>UK</td>
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<td>Zimbabwe</td>
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<thead>
<tr>
<th>Reciprocity</th>
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<tbody>
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<td>Non-EU reciprocity applies.</td>
</tr>
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<td>Croatia</td>
<td>Non-EU reciprocity applies.</td>
</tr>
<tr>
<td>Cyprus</td>
<td>Non-EU reciprocity applies.</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>Non-EU reciprocity applies – currently Iceland, Macedonia, Norway and Switzerland.</td>
</tr>
<tr>
<td>Estonia</td>
<td>Non-EU reciprocity applies.</td>
</tr>
<tr>
<td>Germany</td>
<td>Non-EU reciprocity applies. Germany has a list of qualifying countries.</td>
</tr>
<tr>
<td>Greece</td>
<td>Non-EU reciprocity applies. Refunds are restricted to Norway and Switzerland.</td>
</tr>
<tr>
<td>Hungary</td>
<td>Non-EU reciprocity applies. Refunds are restricted to Switzerland and Liechtenstein.</td>
</tr>
<tr>
<td>Italy</td>
<td>Non-EU reciprocity applies. Applied strictly.</td>
</tr>
<tr>
<td>Jersey, Channel Islands</td>
<td>Reciprocity conditions apply.</td>
</tr>
<tr>
<td>Lebanon</td>
<td>Reciprocity conditions apply.</td>
</tr>
<tr>
<td>Lithuania</td>
<td>Non-EU reciprocity applies. Applied strictly. Refunds are permitted for taxpayers from Armenia, Canada, Iceland, Norway, Switzerland and Turkey.</td>
</tr>
<tr>
<td>Macedonia</td>
<td>Reciprocity conditions apply.</td>
</tr>
<tr>
<td>Poland</td>
<td>Non-EU reciprocity applies.</td>
</tr>
<tr>
<td>Portugal</td>
<td>Non-EU reciprocity applies.</td>
</tr>
<tr>
<td>Romania</td>
<td>Non-EU reciprocity applies.</td>
</tr>
<tr>
<td>Serbia</td>
<td>Reciprocity conditions apply.</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>Non-EU reciprocity applies.</td>
</tr>
<tr>
<td>Slovenia</td>
<td>Non-EU reciprocity applies.</td>
</tr>
<tr>
<td>South Korea</td>
<td>Reciprocity conditions apply.</td>
</tr>
<tr>
<td>Spain</td>
<td>Non-EU reciprocity applies. Refunds are restricted to Canada, Israel, Japan, Morocco, Norway and Switzerland. However, this does not apply to expenses on accommodations, travel and restaurant costs related to attendance at fairs or exhibitions in Spain.</td>
</tr>
<tr>
<td>Switzerland</td>
<td>Switzerland refunds VAT to all EU Member States plus Australia, Bahrain, Bermuda, Canada, Hong Kong, Israel, Japan, Macedonia, Monaco, Norway, Saudi Arabia, Taiwan, Turkey and US.</td>
</tr>
</tbody>
</table>
The OECD view

The OECD’s *International VAT/GST Guidelines* set standards on VAT/GST neutrality and on destination-based taxation of cross-border sales of services to businesses (B2B) and final consumers (B2C). Together, these standards should help make certain that VAT targets private consumption, not businesses, and that sales are taxed effectively in the country of consumption.

Reciprocity

2.27 According to the guidelines on neutrality, foreign businesses should not be disadvantaged or advantaged compared with domestic businesses. This means that foreign businesses should not incur irrecoverable VAT/GST when this would constitute an unjustified discrimination compared with domestic businesses. A number of approaches can be used for this purpose, such as giving direct refunds to foreign businesses, providing refunds through a domestic registration procedure or making supplies VAT-free.

2.28 Some jurisdictions make granting refunds to foreign businesses conditional upon similar relief being granted by the jurisdiction of the foreign business claimant.

These requirements for reciprocity generally take two forms: a formal bilateral agreement between jurisdictions or a unilateral decision to recognize jurisdictions considered as having (or not having) appropriate features in their legislation.

2.29 The guidelines take no position on the desirability of jurisdictions adopting reciprocity requirements. However, insofar as jurisdictions choose to adopt such requirements, they should do so in a manner that minimizes their impact on neutrality.

2.30 It is important to consider the scope of the reciprocity requirements. In the context of the guidelines, a reciprocal mechanism would not be required from a jurisdiction that does not have a VAT system, as defined for the purpose of these guidelines.

Jurisdictions are encouraged to treat other jurisdictions’ mechanisms as satisfying reciprocity requirements if they are designed to promote VAT-neutral treatment for foreign businesses and achieve a substantially equivalent treatment. A substantially equivalent treatment might, for example, result as much from a mixture of VAT-free supplies and local registration mechanisms as from the application of a direct refund approach.

Footnotes:

Deadlines: individual countries may impose different deadlines. Claimants must adhere to the rules carefully, as late claims are generally rejected.

In the EU, for EU claimants, the deadline is 30 September of the year following the calendar year when the expenses were incurred. For invoices dated 1 January to 31 December 2017, for example, the deadline for submission would be 30 September 2018.

The deadline is tighter for non-EU claimants. The deadline for annual claims is generally 30 June of the year following the calendar year when the expenses were incurred. For invoices dated 1 January to 31 December 2017, the deadline for submission would be 30 June 2018. There are, however, certain exceptions. In the UK, VAT refund claims for non-EU businesses are based on a “prescribed year” running from 1 July to 30 June. The deadline for submission of annual claims in the UK is six months after the end of the prescribed year — i.e., 31 December.

Foreign businesses often struggle to meet strict deadlines. Although six or nine months after the year-end may seem like generous time limits, they can prove difficult to meet without forward planning. Claimants should have all the necessary paperwork, including certificates of taxable status and supporting documentation, ready well in advance so they can submit the claim on time.
Appeals: if a foreign VAT/GST refund claim or claim for late-paid interest is denied, the claimant may be eligible to appeal. All EU Member States provide for appeals procedures.

Documentation: the application must generally be accompanied by original documents. The exact requirements may vary by country, but tax administrations commonly require:

- Proof of entitlement/status, such as a certificate from the tax authorities in the claimant’s country proving that it is in business
- Documents appointing a tax representative in countries where that is required
- Documents that support each VAT/GST amount claimed, such as original invoices, import documents, bills, vouchers, receipts or customs clearance forms (PDF copies or other copies of invoices may not be acceptable, so the first step in making a successful claim may be to make certain you receive an original invoice from your suppliers)
- Valid tax invoices that comply with the rules in that country

Interest on late refunds: most countries aim to refund VAT/GST within certain time limits (e.g., six months after the claim date). In practice, these time limits may not be met, and claimants may be further entitled to amounts of late-payment interest. However, not all countries allow for interest payments on late refunds. Those that do may not pay interest automatically, so claimants must apply separately for these amounts.

Late-paid foreign VAT/GST refunds are a common cause of negative cash flow. Businesses that incur large amounts of foreign VAT/GST may want to improve their cash flow by taking measures to avoid incurring foreign VAT/GST or to shorten VAT/GST recovery times. Where it is available, VAT/GST registration may be a preferable option.

Tax representatives and signatures: some countries require the appointment of a locally accredited tax representative before a refund claim can be filed. In addition, many countries apply strict requirements on who has the right to sign the application form (e.g., president of the board of directors). Again, it is advisable to check these requirements well in advance, certainly before filing the claim. It can take time to appoint a representative, for example, especially if the mandate needs to be translated and notarized.

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Case study

A Qatar company participates in a trade fair in Germany in October 2016; it receives invoices with German VAT for the trade fair participation (admission fee, stand, electricity charges, flowers, security, etc.), together with hotel invoices, taxi invoices, restaurant invoices, etc., incurred by its employees who attended the fair. Provided the participation in the trade show was related to its business activity, the Qatar company may recover the VAT on these costs. To do so, the Qatar company must:

- Collect the original invoices it received for the expenses
- Meet the German tax authorities’ invoice requirements on each invoice
- Obtain a certificate of taxable status (tax certificate) from the Qatar tax authorities
- Fill in the special claim form (in German)
- Sign the claim form and send it, together with the tax certificate and the original invoices, to the German tax authorities by the applicable deadline in Germany, i.e., 30 June 2017
Many foreign VAT/GST claims relate to expenses incurred on business trips, so it is vital that all employees who incur foreign VAT/GST understand the documentation required to support valid claims.

Electronic invoices: in the digital age, companies are increasingly issuing electronic invoices and receipts, even for retail sales. While most countries now permit suppliers to issue electronic invoices, not every electronic invoice or receipt is considered valid for VAT/GST refund purposes. For example, some countries may require an electronic invoice to contain an advanced electronic signature.

Claimants who wish to include electronic invoices in their refund claims should check whether it is permitted in the country where they are seeking a refund and verify that their supplier’s invoices comply with the rules in that country.

Tax invoices: the VAT/GST invoice requirements differ among countries, even among EU Member States. However, in general, a valid VAT invoice should include:

- Date of issue
- Invoice number
- Full name, address and VAT registration number of the supplier
- Quantity and nature of goods or services received
- Unit price or the consideration for the service supplied
- Date of the supply
- VAT rate applied
- VAT amount payable

The invoice requirements are subject to change from time to time, so it is advisable to check that the invoice received complies with the latest requirements. For example, new rules may apply for electronic invoices.

Insight

Businesses may be able to attach soft copies of documentation to online claim applications. However, there can be practical challenges in some countries, where the file size can be too large to attach.
Should you register for VAT/GST locally?

Few countries make direct VAT/GST refunds to nonresident claimants. Global businesses must explore other options to reduce and avoid irrecoverable costs or long delays.

The rules for becoming a VAT/GST taxpayer differ from country to country.

Even if other refund mechanisms are available, nonresidents may prefer to be treated as local taxpayers rather than use mutual recovery procedures. However, the costs and ongoing compliance obligations associated with a local VAT/GST registration must also be considered.

Generally, eligibility for local VAT/GST registration depends on the applicant’s business activities. Even without a local presence, some nonresidents are obliged to register as VAT/GST taxpayers – for example, because they supply B2C goods or services.

Not all countries provide for local VAT/GST registration by nonresidents. And those that do may impose conditions or restrictions before granting this facility. For example, some countries require nonresidents to appoint a local fiscal representative or provide a bank guarantee to cover any refunds.
Issues to consider when you want to recover VAT/GST as a nonresident

<table>
<thead>
<tr>
<th>Business activities</th>
<th>Obligations</th>
<th>Considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>▶ Do we have a presence in this country (e.g., an office, a warehouse, staff or an agent)?</td>
<td>▶ Are we obliged to register for VAT/GST?</td>
<td>▶ What are the likely costs of registration?</td>
</tr>
<tr>
<td>▶ Do we have a PE or an FE for VAT/GST purposes?</td>
<td>▶ Is registration optional?</td>
<td>▶ What are the likely benefits of registration?</td>
</tr>
<tr>
<td>▶ Do we have customers in this country?</td>
<td>▶ Is registration possible?</td>
<td>▶ Can we recover the VAT/GST on our costs?</td>
</tr>
<tr>
<td>▶ What activities do we perform?</td>
<td>▶ Do we need to use a local representative?</td>
<td>▶ Do we need to adapt our accounting and reporting processes?</td>
</tr>
<tr>
<td>▶ Do we only incur costs in this country?</td>
<td>▶ Do we need to charge VAT/GST to customers?</td>
<td>▶ Do we need to adapt our documentation?</td>
</tr>
<tr>
<td>▶ Are things likely to change?</td>
<td>▶ Do we need to file VAT/GST declarations?</td>
<td>▶ Who will fulfill our obligations?</td>
</tr>
<tr>
<td>▶ Do we give away products without charge (e.g., pharmaceutical companies that provide drugs for clinical trials or businesses that give free samples to prospective customers)?</td>
<td>▶ Do we need to issue invoices?</td>
<td>▶ Do we have the resources?</td>
</tr>
</tbody>
</table>

Registration as a nonresident

Local VAT/GST registration may be a useful strategy for recovering foreign VAT/GST.

Once registered for VAT/GST in a foreign jurisdiction, a nonresident business is effectively treated as a domestic VAT/GST taxpayer and can recover input VAT/GST.

In fact, local VAT/GST registration may be the only way for nonresidents to recover VAT/GST in many countries. The Worldwide VAT, GST and Sales Tax Guide sets out detailed VAT/GST rules in 120 countries. As of 1 January 2017, only 38 countries refund VAT directly to non-established businesses that are not registered for VAT/GST. But at least 20 of the remaining 82 countries note that nonresidents may be able register for VAT/GST locally and this option may also apply in practice in other countries.

Permanent and fixed establishments
Foreign subsidiaries, branches, and other permanent establishments (PEs) and fixed establishments (FEs) that provide taxable goods or services in a country are generally permitted or required to register for VAT/GST in the country where they are located. Local VAT/GST registration may also be granted to representative offices, warehouses and similar establishments even if they do not constitute a PE or FE for tax purposes.

VAT/GST registration may be required for foreign suppliers of goods and services even if they do not have any presence, for example, because they supply digital services or because they buy and sell goods located in the foreign jurisdiction.

Digital services
Suppliers of digital services may be required to register for VAT/GST even when they have no presence.
Increasingly, VAT/GST is being applied to cross-border digital services (also known as e-services) in the country where the service is “consumed” (usually where the customer is resident). Commonly, e-services include downloads of software, music, books and similar content, as well as digital advertising and cloud-based activities.

### Charging VAT/GST on digital services:

In some countries, if the e-service supplier is a nonresident, the customer is obliged to withhold VAT/GST or self-assess for the tax due. This rule often applies to certain classes of customer (e.g., for B2B supplies). But for services supplied to final consumers (B2C supplies), the obligation to account for VAT/GST is increasingly falling on the nonresident suppliers. As a result, many nonresidents are now required to register for VAT/GST and collect and remit the tax due on their activities in a number of foreign jurisdictions.

### Do these obligations also carry rights?

In many countries, the answer is “yes.” In South Africa, for example, a nonresident e-service provider can recover any VAT paid on any eligible costs incurred in that country through its local VAT registration (generally by offsetting the amount of tax paid as input tax against VAT charged as output tax on sales). However, in the European Union, the position may be more complex.

### EU rules:

**Suppliers of digital services** that provide services to final consumers in the EU (B2C) are generally required to charge VAT in the customer’s Member State of residence. If the supplier is not resident in the same EU Member State, it must register for VAT there or use MOSS.

In defining an fixed establishment (FE) for VAT/GST purposes, most countries apply different criteria from those used to define a permanent establishment (PE) for direct tax purposes. In 41 countries surveyed, the existence of an FE for VAT/GST does not mean that a foreign business automatically has a PE for direct tax purposes or vice versa. However, in 17 countries surveyed, the tax administration does automatically link FE and PE (Algeria, Argentina, Egypt, Estonia, Greece, Indonesia, Jamaica, Kenya, Malawi, Mauritius, Peru, Slovak Republic, South Korea, Switzerland, Turkey, Uruguay and Zambia).

In an additional 15 countries, the existence of an FE for VAT/GST is influential in determining PE status (Bulgaria, Congo, Croatia, Cyprus, Czech Republic, Hungary, India, Luxembourg, Malta, Portugal, Romania, Singapore, Spain, Sweden and the UK). The link between FE and PE is particularly strong in the EU.

**Source:** *Managing indirect taxes in the digital age*, EYGM Limited, 2016 (accessed via ey.com/indirectdigital)
The interactive *Worldwide Indirect Tax Developments Map* tracks legislative changes around the world

The tracker is designed to help you keep abreast of global changes in VAT, GST and other sales taxes, global trade, and excise and other indirect taxes. Updated monthly, it provides a brief outline of what is happening, where and when.

The information can be filtered by country, tax type and the type of change or date.

Access the map at ey.com/indirectmap
E-service providers that use MOSS must charge VAT on their B2C sales in each Member State where they have customers and remit the amounts to the Member States involved. However, they cannot recover input tax using this simplified form of VAT registration. Instead, they must register for VAT in each Member State where they have customers (and charge and offset VAT as if they were domestic taxpayers). Or they must request a refund using the EU VAT recovery procedures for EU and non-EU businesses.

Refunds for specific buyers or goods

Identifying where VAT/GST may be refunded or avoided is a vital aspect of planning cross-border activities. Countries that do not generally refund VAT/GST to nonresidents may allow refunds for restricted categories of goods and services or for specific purchasers. In some cases, zero-rating may be granted instead (that is, the purchase is effectively treated as a tax-free export). Commonly, refunds or zero-rating may apply to:

- Exports of goods
- Expenses related to attending trade fairs and exhibitions
- Purchases of goods by foreign visitors (and exported in their luggage)
- Purchases made by diplomatic missions and similar organizations

The *Worldwide VAT, GST and Sales Tax Guide* sets out the detailed VAT/GST rules in 120 countries. As of 1 January 2017, only 38 countries refund VAT/GST directly to non-established businesses that are not registered for VAT/GST. But at least 10 additional countries note that other possibilities for VAT/GST recovery may exist and these facilities may also apply in practice in other countries.
Managing domestic VAT/GST credits
Accounting for input VAT/GST correctly and actively managing credits are essential aspects of any effective indirect tax strategy. These may seem like straightforward tasks. But detailed domestic rules on VAT/GST recovery and differences in how countries handle refunds can complicate the picture, especially for global companies.
VAT/GST – never a cost to business?

As a flow-through tax borne by final consumers, VAT/GST should not be a cost to businesses. But that is not always the case. Most VAT/GST payers encounter “sticking tax,” and the financial impact of negative VAT/GST cash flow on working capital may be significant.

Absolute VAT/GST costs
VAT/GST may be an absolute cost to a business for a number of reasons:
- The business is not a VAT/GST payer because its turnover is too small or because it supplies goods or services that are exempt from VAT/GST.
- The business has not yet made any taxable supplies or is not yet registered for VAT/GST.
- The domestic VAT/GST law explicitly excludes the cost from recovery or explicitly excludes the business from recovering input tax.
- The VAT/GST payer does not have the necessary processes to identify the input tax.
- The VAT/GST payer does not have the documentation required to support its claim (e.g., customs document or tax invoices).
- The tax administration refuses the claim because the VAT/GST payer has not complied with the formal requirements (such as time limits or application details).
- The VAT/GST payer incurs an additional tax charge as a penalty for errors or omissions in its VAT/GST accounting.

Negative VAT/GST cash flow
In most VAT/GST systems, VAT/GST paid on allowable business costs is recoverable as input tax as soon as the purchaser has a valid tax invoice – even if the tax has not been paid to the supplier. Where this provision applies, VAT/GST input tax is not always a cash flow cost to businesses; in fact, some VAT/GST payers may even gain a cash flow advantage if they can offset the VAT/GST charged on their purchases before they pay their suppliers.

However, in practice, terms of trade often mean that an invoice is paid before the purchasing business can offset the VAT/GST against output tax on its sales or before it can receive a refund for any excess. And, increasingly, tax administrations, concerned about VAT/GST fraud, are looking to impose conditions that prove the tax has been declared and paid before the VAT/GST charged on their purchases before they pay their suppliers.

VAT/GST may contribute to negative cash flow in a number of ways:
- The terms of business require the purchaser to pay VAT/GST to its supplier before it can offset or recover its input tax.
- The business has not yet made any taxable supplies or is not yet registered for VAT/GST.
- The VAT/GST payer has an excess of input tax that cannot be used to offset output tax.
- The tax administration’s refund procedures are subject to long delays.

The OECD view
The OECD’s International VAT/GST Guidelines.

Guideline 1.2: The overarching purpose of a VAT is to impose a broad-based tax on consumption, which is understood to mean final consumption by households.

Guideline 1.4: The burden of the VAT should not rest on businesses.
Recovering VAT/GST on business costs

What is input tax?

Not all VAT/GST paid on business costs is recoverable as input tax. Making a successful refund claim depends on knowing the detailed rules — in every country where you want to claim. VAT/GST paid on most business expenses can be offset (or recovered) as input tax, but some expenditures do not qualify for recovery. All VAT/GST taxpayers must distinguish between recoverable and irrecoverable input tax to offset, claim and pay the right amount of tax in their accounts. Errors can lead to negative cash flow and absolute costs, as well as tax penalties.

Input tax may include VAT/GST paid on imports, domestic purchases and any VAT/GST self-assessed by the business (e.g., on the purchase of digital services). Each country has its own rules for the VAT/GST that may be recoverable as input tax — and about the documentation that must be presented to support the claim. Even in trading blocs such as the EU, these rules may differ widely, requiring taxpayers to have detailed local knowledge.

The Worldwide VAT, GST and Sales Tax Guide sets out the detailed VAT/GST recovery rules in more than 120 countries.

The OECD view

Tax neutrality
The OECD’s International VAT/GST Guidelines:

“In domestic trade, tax neutrality is achieved in principle by the multi-stage payment system: each business pays VAT to its providers on its inputs and receives VAT from its customers on its outputs. To ensure that the ‘right’ amount of tax is remitted to tax authorities, input VAT incurred by each business is offset against its output VAT, resulting in a liability to pay the net amount or balance of those two. This means that VAT normally ‘flows through the business’ to tax the final consumers. It is therefore important that at each stage, the supplier be entitled to a full right of deduction of input tax, so that the tax burden eventually rests on the final consumer rather than on the intermediaries in the supply chain.”
Recoverable input tax
Most tax administrations apply strict rules to the recovery of input tax. Some general principles include:

- The claimant must be an eligible taxable person.
- The input tax must relate to a legitimate business expenditure.
- The input tax must relate to a taxable business activity or to an activity treated as exempt with credit (e.g., export sales).
- The amount of tax claimed or offset must be supported by valid documentation (e.g., a VAT/GST invoice or customs document).

Special rules may also apply to the recovery of expenditures incurred before registration or incorporation, or after a business has ceased to operate.

Irrecoverable input tax
Irrecoverable costs commonly include expenditures that could have some “personal” or “nonbusiness” use, such as expenses related to cars, mobile phones, business gifts, hospitality and taxi services.

Common types of expenditures for which VAT/GST is not recoverable as input tax

- Personal or private expenditures
- Alcohol
- Tobacco
- Input tax related to nonbusiness activities
- Input tax related to activities exempt from VAT/GST
- Purchase of cars
- Car hire, parking, car maintenance and gasoline
- Hotel costs
- Business entertainment and hospitality
- Business gifts
Seven key issues that prompt VAT/GST penalties

We asked indirect tax professionals in 82 countries within the EY network to tell us the most common issues that lead to VAT/GST assessments and penalties. These were their answers:

1. Disallowed input tax (for example, errors in items claimed and disputes over business use) – 53 of 82 countries
2. Lack of documentation (for example, missing export declarations and supporting documentation for input tax) – 47 of 82 countries
3. Formal mistakes (for example, incomplete invoices and receipts, and errors in invoice details) – 46 of 82 countries
4. Incorrect qualification of turnover (for example, application of the wrong tax rate and characterization of income as exempt instead of taxable) – 33 of 82 countries
5. Inconsistencies between declared VAT/GST and annual financial statements – 24 of 82 countries
6. Processing errors (for example, incorrect coding and issues with master data) – 17 of 82 countries
7. Incorrect calculation of the input VAT/GST pro rata (for partly exempt businesses) – 12 of 82 countries

Source: Managing indirect tax controversy: dealing with audits and disputes, EYGM Limited, 2015 (accessed via ey.com/indirectcontroversy)
Refunds VAT/GST credits automatically

Refunds VAT/GST credits after carryforward

No or limited refunds are available, or the rules are unclear because of planned legislation changes

 Carryforward is the only way to offset VAT/GST credits
Refunds VAT /GST credits automatically after carryforward. Carryforward is the only way to offset VAT /GST credits. No or limited refunds are available, or the rules are unclear because of planned legislation changes.
Where do credits accumulate?

Excess input tax is a common cause of negative cash flow for VAT/GST payers. Receivables may be outstanding for months or even years. Understanding how and where credits arise and taking action to deal with excessive delays and “crunch points” can greatly improve management of working capital.

Different countries treat excess input tax credits in different ways. The excess may, for example, be refunded, carried forward or used to offset other taxes. These different approaches can have significantly different impacts on affected businesses and should be factored into strategic decisions about managing VAT/GST costs and cash flow.

Automatic refunds: as of 1 January 2017, 43 of 120 countries listed in the Worldwide VAT, GST and Sales Tax Guide refund excess input VAT/GST automatically.

Countries that refund automatically

43 out of 120 VAT/GST automatic refunds
In some jurisdictions (such as France), the VAT/GST payer must apply for the refund. In others (such as the UK), a refund is granted automatically on receipt of the VAT/GST return for that period. In some countries (such as Romania and Luxembourg), the VAT/GST payer may choose whether to carry the excess forward or request a refund.

**Carryforward before refund:** as of 1 January 2017, 65 of 120 countries listed require VAT/GST payers to carry forward excess input tax – either to offset future VAT/GST payments or to offset other tax liabilities. Forty-one countries allow taxpayers to request a refund after some period of offset.

**Carryforward exclusively:** as of 1 January 2017, 24 countries apply carryforward as the only way for most taxpayers to offset excess input VAT/GST.

Countries that require VAT/GST payers to carry forward excess input tax

![VAT/GST](image)

65 out of 120

Carryforward before refund
### VAT/GST refunds for domestic businesses

| Refund excess input VAT/GST credits automatically with no carryforward |
|-------------------|-----------------|-----------------|-----------------|
| Austria           | Bahamas         | Belgium         | Canada          |
| Iceland           | Isle Of Man     | New Zealand     | Israel          |
| Austria           | Bahamas         | Belgium         | Canada          |
| Iceland           | Isle Of Man     | New Zealand     | Israel          |
| Bulgaria          | Belgium         | Canada          | Croatia         |
| Isle Of Man       | New Zealand     | Norway          | Japan           |
| Austria           | Bahamas         | Belgium         | Croatia         |
| Iceland           | Isle Of Man     | New Zealand     | Japan           |
| Austria           | Bahamas         | Belgium         | Croatia         |
| Iceland           | Isle Of Man     | New Zealand     | Japan           |
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| Austria           | Bahamas         | Belgium         | Croatia         |
| Iceland           | Isle Of Man     | New Zealand     | Japan           |

| Refund input VAT/GST credit after carryforward |
|---------------------|---------------------|---------------------|---------------------|
| Albania             | France              | Lithuania           | Seychelles          |
| Australia           | Georgia             | Luxembourg          | Slovak Republic     |
| Azerbaijan          | Ghana               | Macedonia           | Slovenia            |
| Belarus             | Greece              | Malta               | Spain               |
| Botswana            | Hungary             | Mexico              | Tanzania            |
| Bulgaria            | Indonesia           | Poland              | Tunisia             |
| Colombia            | Italy               | Portugal            | Uganda              |
| Costa Rica          | Jordan              | Romania             | Ukraine             |
| Croatia             | Kosovo              | Russia              | Vietnam             |
| Estonia             | Latvia              | Saint Lucia         | Zimbabwe            |
| Finland             | Lebanon             |                    |                     |

| Carry forward input VAT/GST credit against future tax payments (most taxpayers) |
|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| Argentina                   | Chile                       | Honduras                    | Panama                      |
| Armenia                     | Cyprus                      | Kenya                       | Paraguay                    |
| Barbados                    | Dominican Republic          | Mauritius                   | Peru                        |
| Bolivia                     | Ecuador                     | Morocco                     | Turkey                       |
| Brazil                      | El Salvador                 | Myanmar                     | Uruguay                      |
| China                       | Guatemala                   | Nicaragua                   | Venezuela                    |
### Accelerated refunds available for certain types of taxpayers

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<tr>
<th>Country 1</th>
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<th>Country 3</th>
<th>Country 4</th>
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<tbody>
<tr>
<td>Argentina</td>
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<td>Moldova</td>
<td>South Korea</td>
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<td>Armenia</td>
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<td>Pakistan</td>
<td>Taiwan</td>
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<td>Bulgaria</td>
<td>Jordan</td>
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<td>Tanzania</td>
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<td>China (mainland)</td>
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<td>Portugal</td>
<td>Tunisia</td>
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<td>Kenya</td>
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<td>Maldives</td>
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<td>Guatemala</td>
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### Refund VAT/GST on pre-registration expenses

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Managing input tax credits

What causes input VAT/GST credits?

Input tax credits are an inevitable part of the VAT/GST system. They arise when the VAT/GST paid on a VAT/GST payer’s purchases (input tax) in a tax period is greater than the VAT/GST charged on its sales (output tax) in that period.

Most businesses are likely to incur excess input tax credits at some point as a result of either extraordinary expenditures or their operations. Do you know why and where VAT/GST credits may arise in your business and where they may be of the greatest concern?

One-off credits: for many businesses, having excess input tax is a temporary or occasional situation. For example, expenses may exceed sales in the start-up or exploratory phase of a new venture or during a major expansion.

Seasonal trading: in some sectors, seasonal trading patterns may contribute to excess input tax. For example, a manufacturer or retailer may acquire excess inventory in the months prior to a busy shopping period.

Systemic input tax credits: some businesses frequently experience excess input tax credits because of the nature of their trading activities. For example, for frequent exporters, the VAT/GST they pay on imports and domestic purchases is generally likely to exceed their output tax, as exports are VAT/GST free. Similarly, excess input tax is common for vendors and manufacturers of foodstuffs and other goods that attract reduced rates of VAT/GST (such as pharmaceuticals, books and hospitality services) because their raw materials and overhead often attract VAT/GST at a higher rate than applies to their sales.

Whether this is a serious concern depends on the size of the credit and how quickly the amount will be reimbursed. Over time, these “peaks” and “troughs” often even out so that any excess credit is absorbed. But one-off or occasional credits may still constrain cash flow if the amounts are large or if the refund is delayed for extended periods, as may happen in some countries. Businesses that consistently have excess input tax credits should make dealing with them effectively a crucial part of corporate cash management so they can accelerate refunds and avoid or reduce unnecessary VAT/GST payments.

Common reasons for domestic VAT/GST credits

- Seasonal trading and preparing for future busy periods or major projects
- Exporting (making sales without VAT/GST)
- Selling goods or services at a reduced or zero rate
- Trading at a loss
- Undertaking building or refurbishment works; outfitting factories, offices and shops
- Business start-ups
- Business expansions
- Acquiring capital assets
Input tax credits and cash flow

Carrying forward excess input tax is one of the biggest cash flow concerns for VAT/GST payers.

**Carryforward and offset**: indefinite carryforward is a major concern, especially for VAT/GST payers that commonly accumulate excess input tax. Even when a refund of VAT/GST is paid after a period, the cash flow impact may be severe if the carryforward period is long.

The time that excess input tax must be carried forward before it can be refunded varies greatly by country. It may be as short as one to three months (e.g., in Azerbaijan, Belarus and Ghana) or it may be as long as six months to a year (e.g., in Jordan, Lebanon and Portugal).

To offset the impact of negative cash flow on businesses that are in a persistent VAT/GST refund position, many countries allow some taxpayers to apply for input tax refunds instead of carrying forward the excess or to apply for refunds more quickly. These special provisions often apply to exporters or to businesses that sell goods or services that benefit from reduced VAT/GST rates. More than 50 jurisdictions listed in the *Worldwide VAT, GST and Sales Tax Guide* indicate that they apply special provisions to accelerate refunds.

**Financing costs**: in addition to financing costs to cover input tax before it is refunded or offset, taxpayers may also be required to post a bank guarantee to cover the refund amount.

**Lengthy tax periods**: although the availability of automatic VAT/GST refunds may greatly reduce the VAT/GST cash flow impact of input tax credits, especially compared with carrying forward excess balances indefinitely, financial costs and negative cash flow may still occur. This is a common issue if the VAT/GST return period is greater than one month (e.g., in Ireland and the UK). Businesses may carry financing costs related to input tax incurred on purchases made at the start of the tax period for several months before it can be recouped. This may be a particular issue for businesses that generally incur more input tax than they declare in output tax (such as exporters, food manufacturers and booksellers). In many countries (such as Argentina, Botswana and the Slovak Republic), these classes of businesses may benefit from special arrangements that allow them to request refunds more frequently.

**Tax administration delays**: the time limit set by domestic legislation for the tax administration to pay a refund may be exceeded in practice, sometimes by months or years. Many countries (such as Barbados, Croatia, Ghana, Kosovo and the UK) pay interest to VAT/GST payers whose refunds are delayed without justification. However, even when late-repayment interest applies, it may not be paid at a commercial rate, or the VAT/GST payer may have to request it separately or even lodge an appeal for it to be paid. Businesses that face persistent refunds or significant costs associated with delays may pursue other methods to offset excess tax (e.g., through grouping) or avoid incurring VAT/GST on purchases (e.g., through the reverse charge).
VAT/GST audits: it is common for VAT/GST refunds to be granted only on completion of a satisfactory tax audit or after the tax administration has investigated the validity of the claim. The need for an audit may greatly delay repayments. Generally, any time taken for tax administration inquiries will not count as contributing to the unjustified delay for late-repayment interest.

Audits are particularly common if the claim is “unusual” — for example, if the amount is large, if the payer does not generally request refunds or if this is a new payer’s first return. The audit procedure may apply at the tax administration’s discretion, or it may be an automatic part of the refund process. The tax administration auditors may visit the payer’s business premises, or the review may be carried out “off-site,” using advanced technology to identify risks and verify documents.

These tax administration practices are understandable given the prevalence of past fraud related to input tax claims and the high incidence of taxpayer errors. VAT/GST payers who request refunds should be aware of the likelihood that their claims may be audited and should prepare accordingly. Planning for a possible audit can greatly reduce the chances that claims will be denied or delayed. Well-documented policies and procedures, a clear audit trail, and complete and correct documentation should support any claim.

Developing a strategy for domestic VAT/GST credits

Delayed and irrecoverable VAT/GST on starting a business or entering a new market can hit a business in a crucial phase. Developing an effective strategy can improve cash flow and reduce associated costs.

Footnote:
1 Read more in Managing indirect tax controversy: dealing with audits and disputes, EYGM Limited, 2014 (accessed via ey.com/indirectcontroversy)
# Key considerations for managing domestic VAT/GST credits

What are the crucial questions to consider?

<table>
<thead>
<tr>
<th>Key questions</th>
<th>Identify</th>
<th>Consider</th>
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<tbody>
<tr>
<td><strong>Do you have excess input tax?</strong></td>
<td>Where your business has incurred or will incur excess input VAT/GST</td>
<td>Where do you have excess input VAT/GST? What are the bulk-ticket items? Where are the key jurisdictions? Is this a one-off situation? Is this likely to be persistent?</td>
</tr>
<tr>
<td><strong>Can you claim a refund?</strong></td>
<td>Country rules Eligible entities Eligible costs Time limits</td>
<td>Do the countries where you are incurring excess input VAT/GST refund it? Must you carry it forward? Could you qualify for a faster refund? What are the specific rules in each country? What are the likely roadblocks? Do you have alternatives?</td>
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<td></td>
<td>The reasons, sources and types of expenditures you have</td>
<td>Which amounts and general ledger accounts are most significant for your business? Does VAT/GST apply? Is this VAT/GST recoverable?</td>
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<td>What you need to do to claim Any gaps between what you have and what you need to claim</td>
<td>Do you have suitable processes? Do you have the documents, forms and supporting material you need? Are you on time?</td>
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<td><strong>Is it worth it?</strong></td>
<td>The likely costs and benefits</td>
<td>How much is involved? What are the absolute costs? What are the financing costs? Will your claim stand up to an audit?</td>
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<tr>
<td><strong>What are your alternatives?</strong></td>
<td>Opportunities to structure business transactions to avoid or reduce excess VAT/GST or to improve cash flow</td>
<td>Can you make domestic purchases VAT-free? Can you import goods and services VAT-free or with deferred payment? Can you consolidate your inputs and outputs with group companies? Can you accelerate refunds by making taxable supplies sooner? Are there major differences among locations in terms of recoverability or timing of refunds? Should you restructure your business activities? Should you change your processes or documentation?</td>
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</table>
Setting up a new company, starting a new business venture or entering a new market is a crucial stage in the life of any business – when effective cash management is vital to success. These phases can also be common sources of excess input tax credits because most new businesses pay VAT/GST on setup costs before they start to trade and charge VAT/GST on their sales. Engaging in strategic planning and taking action can greatly improve VAT/GST cash flow and reduce additional VAT/GST costs.

Most new businesses incur VAT/GST before activity begins and before they start to charge tax on their sales. In many countries, the VAT/GST paid prior to commencing activity is recoverable as input tax once the business is registered for VAT/GST. However, in some countries, registration may not be granted before activities begin and, in others, certain costs are blocked or time restrictions apply.

For some ventures, the start-up phase may take many years, requiring extensive building works or preparatory activities before trade can begin. Even if activities commence quickly, pre-registration charges can constrain cash flow. And if the VAT/GST is not recoverable, these charges can become absolute costs.

### Business start-up costs

| Recovering VAT/GST on business start-up costs |
| Where is VAT/GST recoverable on business start-up costs? |
| Conditions for recovering VAT/GST on business start-up costs |
| Improving VAT/GST recovery on business start-up costs |
| Developing a strategy for VAT/GST on business start-up costs |

### Common pre-registration VAT/GST costs

- Legal and professional fees
- Goods for resale
- Building works
- Acquiring and occupying business premises
- Outfitting factories, offices and shops
- Marketing and advertising
- IT and technology
- Telecommunications
- Office supplies and equipment
- Printing
- Business travel
Where is VAT/GST recoverable on business start-up costs?

55 of 120 countries refund input VAT/GST incurred on pre-registration costs.

As of 1 January 2017, 55 of 120 countries listed in the Worldwide VAT, GST and Sales Tax Guide refund input VAT/GST incurred on pre-registration costs, subject to certain conditions. Eight countries covered by the guide have yet to identify rules on this issue, and five others do not refund VAT/GST in any case. So, in effect, around 50% of countries that permit VAT/GST recovery allow input tax credit for pre-registration expenses.

Conditions for recovering VAT/GST on business start-up costs

Strict conditions apply to VAT/GST incurred on business start-up costs. Knowing and complying with the detailed rules in each country where you want to claim are crucial factors for success.

Time limits, registration formalities and specific input tax restrictions can lead to long delays and missed opportunities, causing not only negative cash flow but also loss of input tax recovery.

Key considerations include:

VAT/GST registration prior to business activity: becoming a taxable person is a prerequisite for input VAT/GST recovery. Where possible, start-ups should register for VAT/GST as soon as possible, even before they commence activities, to reduce cash flow delays and prevent VAT/GST on some costs from being “out of time.” To obtain registration in these circumstances, new businesses may need to provide evidence to the tax administration that they will carry out taxable activities in the future, for example, by providing copies of signed contracts.

Countries that refund pre-registration expenses

55 out of 120 pre-registration expenses
Managing domestic VAT/GST credits

The Worldwide VAT, GST and Sales Tax Guide outlines indirect tax compliance information in 122 jurisdictions around the world — the Gulf Cooperation Council, Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates being the latest additions for 2017. For each country we describe:

- At a glance, the basic features of the major indirect tax in this jurisdiction, the scope and who is taxable
- The rates and how the country has defined the time of supply
- When taxpayers can recover VAT/GST they’ve paid on inputs
- The rules on filing, payment and penalties

Access the guide at ey.com/vatguide

**Restricted input tax:** in some countries, VAT/GST recovery on costs incurred prior to registration may be restricted to certain costs. Restrictions vary by country. Commonly permitted expenses include capital assets, pre-incorporation costs, goods held in inventory at the date of registration and services related to setting up the business tax recovery in 120 jurisdictions.

**VAT/GST invoices:** input tax recovery for pre-registration costs may be blocked because the claimant does not have a valid tax invoice or other adequate documentation to support recovery. The rules for tax invoices vary by country. In some countries, such as Malta, the purchaser’s VAT/GST identification number must appear on the invoice, which may greatly restrict input tax recovery on business start-up costs in practice.

**Time is of the essence:** VAT/GST recovery cannot begin until the claimant is a taxable person, so new businesses should register for VAT/GST as soon as possible. Also, many countries apply time limits to input tax recovery for pre-registration costs. Time limits vary by country. Commonly, VAT/GST is recoverable on goods for resale that are disposed of after registration, irrespective of when they were acquired. However, input VAT/GST incurred on asset acquisition, building costs and services may be restricted to the months immediately prior to registration. Where time limits apply, early VAT/GST registration is particularly important to avoid incurring irrecoverable costs.

**Delayed recovery:** even where input tax recovery is permitted for pre-registration expenses, the input tax may not be refunded until the business begins to make taxable supplies, which can lead to long delays.
Developing a strategy for VAT/GST on business start-up costs

Delayed and irrecoverable VAT/GST on starting a business or entering a new market can hit a business in a crucial phase. Developing an effective strategy can improve cash flow and reduce associated costs.

Improving VAT/GST recovery on business start-up costs

Exploring alternatives may help new businesses to avoid incurring irrecoverable VAT/GST on setup costs or to greatly reduce the financial impact of long delays. Consider these alternatives:

Using entities already registered for VAT/GST: undertaking new activities in entities that are already making taxable supplies may allow input tax to be recovered on costs associated with a new undertaking that would otherwise not be eligible. It may also improve cash flow by allowing for an immediate offset, before sales from the activity begin.

Choosing business locations based on recovery: the rules for recovering VAT/GST on business start-up costs vary greatly by country. Therefore, decisions about where to locate business premises and activities may have significant cost or cash flow implications for a new or expanded business.

Making taxable supplies sooner: in countries where VAT/GST registration is not permitted prior to business activity, VAT/GST registration is compulsory once a business begins to supply taxable goods or services. Therefore, making some taxable supplies as soon as possible can reduce irrecoverable VAT/GST. Obtaining this status can also improve cash flow in countries where recovery on pre-registration expenses is delayed until the taxpayer begins to charge VAT/GST.

Acquiring an existing company or business: in many countries, the transfer of the shares in a company may be exempt from VAT/GST. Similarly, the transfer of a business as a going concern may be VAT/GST-free. These rules may also apply to part of a business if it is capable of separate operation (e.g., an autonomous division). Acquiring a company or the assets and inventory of an existing business – rather than starting from scratch – may significantly reduce the input tax that the new owner incurs.
### Key considerations for managing pre-registration input VAT/GST

What are the crucial questions to consider?

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<td>What are your alternatives?</td>
<td>Opportunities to structure the transaction to avoid or reduce irrecoverable VAT/GST or to improve cash flow</td>
<td>Can you structure your business start-up differently?</td>
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<td>For example, can you acquire a going concern or use a local subsidiary that is already a taxable person?</td>
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<td>Can you accelerate refunds by making taxable supplies sooner?</td>
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<td>Are there major differences among locations in terms of recoverability or timing of refunds?</td>
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<td>Should you restructure your business activities?</td>
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</table>
Avoiding or reducing domestic VAT/GST credits

Managing VAT/GST refunds and credits involves looking critically at the VAT/GST you pay and identifying ways to buy goods and services VAT/GST-free.

Pay the right amount of tax
VAT/GST is recoverable as input tax only if it is properly charged. Because tax administrations are likely to focus on supplies where the full rate of VAT/GST is not applied, suppliers may be reluctant to apply zero-rating, reduced rates or exemptions, even when they are fully justified. This issue may also apply to cross-border supplies, especially in countries where taxpayers face harsh penalties for errors in VAT/GST accounting. But this “extra” VAT/GST is not really a tax—it is an additional cost component. Actively examining where you may be overpaying VAT/GST—and challenging suppliers to apply justifiable exemptions and reduced rates—can greatly improve cash flow and reduce absolute VAT/GST costs.

Acquire cross-border goods VAT/GST-free

Imports: many jurisdictions allow importers to defer payments of VAT/GST on imports. Instead of paying VAT/GST to clear their goods at the border, importers may be allowed to account for and offset the tax due (using a reverse charge) on their VAT/GST declarations, thus avoiding a payment and refund.

Intra-Community supplies: in the EU, this procedure applies automatically to B2B acquisitions of goods acquired from other Member States. In the EU, even if VAT/GST deferment is not available for imports from third countries, routing the supply chain to increase intra-Community acquisitions can greatly improve cash flow (e.g., by purchasing from EU suppliers or by importing into another Member State).

Exports: frequent exporters often carry excess VAT/GST credits because they pay tax on their imports and domestic purchases but do not charge VAT/GST on their export sales. Many countries allow frequent exporters to claim domestic VAT/GST refunds even if other businesses cannot. Others may let exporters claim tax more frequently (e.g., by submitting monthly rather than quarterly returns). In addition, some countries (such as France, Ireland and Italy) may allow exporters to reduce their VAT/GST credits by purchasing domestic goods free of VAT/GST. Under this system, domestic sales of goods and services made to certified export businesses are treated as if they were export sales, allowing them to qualify as VAT/GST-free. Stripping out VAT/GST at this stage of the supply chain can significantly improve cash flow for exporting companies, although certain restrictions or conditions may apply. This export treatment can also improve cash flow for domestic suppliers that sell goods and services to export businesses because it removes the need to charge and account for output tax on these sales.

Investigate VAT/GST paid on global group contracts
Global contracts may be established centrally for purchasing goods and services for a number of subsidiaries in different jurisdictions. However, the application of VAT/GST to the contract may not be considered, and the availability of input tax recovery by the local entities covered by the contract may be easily overlooked by centralized procurement functions. This overlooked VAT/GST may become an additional cost of doing business. Proactively involving the corporate tax function in structuring global contracts and making local accounts payable staff members aware of these arrangements (and verifying that they are claiming the appropriate credits) can release trapped VAT/GST and improve the profitability of the arrangement.

Reduce output tax for bad debts
VAT/GST cash flow issues affect suppliers as well as purchasers. VAT/GST charged on sales must generally be declared and paid to the tax administration by the supplier when a taxable event occurs, even if the customer has not paid (or never pays). Taxable events may include delivering goods, performing a service or issuing an invoice. In some VAT/GST systems (e.g., Bulgaria, Portugal and the UK), a supplier that can prove that its customer will not pay has a bad debt and may reduce its VAT/GST liability.
Strict conditions generally apply (e.g., the purchaser must be insolvent) and may make claims time-consuming. However, adopting robust policies to identify qualifying debts and to claim the appropriate relief may significantly improve VAT/GST cash flow, and the benefits may outweigh the costs, especially for significant debts. The increased use of data analytics and automatic processing may also improve the feasibility and reduce the administrative costs of making these claims.

Use VAT/GST grouping

VAT/GST grouping allows related companies to form a consolidated group. It may benefit payers with excess input tax in a number of ways by allowing for greater offset and by removing tax on intercompany supplies.

Not all countries permit VAT/GST grouping. The Worldwide VAT, GST and Sales Tax Guide sets out the detailed conditions and effects of grouping in 120 countries. Currently, 36 jurisdictions listed in the guide indicate that they allow some form of VAT/GST group. Of these, 20 are EU Member States.

Each country has its own rules about who can form a VAT/GST group. In most countries, grouping is restricted to corporate legal entities that are under common control. This condition typically requires a majority share ownership by one group member (or a common parent) or other close financial ties between the group members. Membership may be extended to qualified overseas companies or branches, or they may be excluded.

Countries that allow VAT/GST grouping

36 out of 120 VAT/GST allow grouping
Wide differences also apply to the effects of VAT/GST grouping. The most significant effects on cash flow include:

- **Consolidated VAT/GST balances.** Grouping allows members to automatically offset input tax and output tax balances. This is an effective way to avoid long refund delays arising from excess input tax and the impact of carrying forward credits against future VAT/GST payments.

- **Disregarded VAT/GST.** Some countries allow VAT/GST group members to be treated as a single taxable person. Where this applies, members can disregard supplies made between them for the purposes of accounting for VAT/GST. Removing tax on intragroup sales can greatly reduce excess input tax, for example, for companies that export goods manufactured by related entities. This helps prevent vertical integration of legal entities for the sake of avoiding indirect taxes because it treats separate legal entities in the same way as branches or divisions.
### VAT/GST Grouping

<table>
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<tr>
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<th>VAT/GST Grouping Summary</th>
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<tbody>
<tr>
<td>Aruba</td>
<td>No</td>
<td>If a parent company owns 100% of the shares in a subsidiary established in Aruba, on request fiscal unity for revenue tax (RT) purposes is recognized and RT is levied on the parent company as if one entrepreneur exists. Turnover generated by intercompany transactions is exempt from RT.</td>
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<tr>
<td>Australia</td>
<td>No</td>
<td>Subject to certain requirements, two or more entities that are closely related may form a GST group. The effect of GST grouping is to treat the group members as a single entity for certain purposes. In general, all GST liabilities and input tax credit entitlements for group members are attributed to a representative member of the group, and the group submits a single GST return (incorporated as part of the Business Activity Statement). The representative member of the group must be an Australian resident. However, nonresidents may be included in a GST group as members. Transactions between group members are not considered taxable for GST purposes and consequently are effectively ignored. Grouping is permitted for companies, partnerships and trusts. For companies to be included in a GST group, they must be connected by a 90% (or greater) share ownership relationship in terms of voting power, right to receive dividends and right to receive capital distributions. However, all eligible companies are not required to be included in a GST group. The rules for the grouping of trusts and partnerships with companies are complex.</td>
</tr>
</tbody>
</table>
| Austria | Yes | To form or join a VAT group, the group members must satisfy the following conditions:  
  - Financial integration: the controlling group member must own at least 75% of the shares of the controlled companies. If the share ownership is between 50% and 75%, the companies may be considered to satisfy the financial integration test if the other conditions are strongly met.  
  - Economic integration: the controlled company's activities support or complement the activities of the controlling entity, and they have a continuous business relationship.  
  - Organizational integration: the management of the controlled company is fully dependent on the will of the controlling company.  
All controlled entities that fulfill the above criteria must be included in the VAT group. The effect of group registration is to treat the members as a single taxable person. Only the controlling entity is registered at the VAT office. The group submits a single VAT return including all the members’ taxable transactions. Transactions between the controlling entity and a controlled company are treated as transactions within a single legal entity and, consequently, they are not taxable. |
<p>| Belgium | Yes | Effective from 1 April 2007, VAT grouping is permitted under the Belgian VAT law. VAT grouping is an option for Belgian businesses and Belgian branch offices of foreign businesses. The option to create a VAT group is subject to various conditions. For example, the businesses must be financially, economically and organizationally linked with each other to form a VAT group. Subsidiaries in which the parent company owns more than 50% of the share capital must normally be included in the VAT group if the parent is a member. Specific rules exist for VAT adjustments when creating a VAT group. Transactions within a VAT group are disregarded for VAT purposes. However, in certain cases, these intragroup transactions may still be subject to VAT. Members must remain part of the VAT group for at least three years. |</p>
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<tr>
<td>Bulgaria</td>
<td>Yes</td>
<td>Unincorporated partnerships. If two or more entities enter into a contract to perform a joint activity, the contract is deemed to form an unincorporated partnership under Bulgarian tax law. This unincorporated partnership is treated as a taxpayer, separate from the founding entities that constitute it. The unincorporated partnership is subject to all the general rules of the Bulgarian VAT law, including those relating to VAT registration, deregistration and reporting. The VAT registration of an unincorporated partnership does not result in the VAT registration of entities that have entered into the contract for joint activity.</td>
</tr>
</tbody>
</table>
| Cyprus         | Yes| VAT grouping is possible for two or more companies registered in Cyprus. The following are the principal aspects of grouping:  
  - One member of the group is appointed as the representative member.  
  - The representative member is responsible for preparing and submitting the VAT returns and for paying or reclaiming any VAT on behalf of all group members.  
  - Any business carried on by a member of the group is treated as being carried on by the representative member.  
  - Any supply of goods or services by a member of the group to another member of the group is disregarded.  
  - Any supply of goods or services by or to a third-party is treated as a supply to or by the representative member.  
  - All members of the group are responsible for any VAT payable by the representative member. |
| Czech Republic | Yes| A group registration for VAT purposes is possible in the Czech Republic. Legal entities that are closely connected (through capital or management) may register as a VAT group. A VAT group is treated as a single taxable person. Only persons established in the Czech Republic may be part of a VAT group. As a result, any establishments (seat or fixed establishment) of such persons outside the Czech Republic may not be part of a VAT group. The group members share a single VAT number and submit a single VAT return.  
  An application for group registration must be filed before 31 October for the group registration to be effective from 1 January of the following year. |
| Denmark        | Yes| Groups of companies or related entities may request registration as a single taxable person (VAT group). If both VAT-registered and VAT-exempt companies are part of a VAT group registration, the parent company must be included in the VAT group. All group members must be 100% owned by the parent company and established in Denmark. The effect of VAT grouping is that no VAT is charged on supplies between group members. However, if any member of the group has exempt activities, the group must deduct input VAT on a pro rata basis. The group members are jointly and severally liable for any VAT on transactions with third parties. |
| Estonia        | Yes| A parent company and its subsidiaries may apply to register as a VAT group. One VAT registration number is provided to all members of the VAT group. The effect of grouping is that no VAT is charged on supplies between group members if the person acquiring the goods or services as a result of the transaction uses them entirely for that person's taxable supplies. Group members are jointly and severally liable for all VAT liabilities. |
## VAT/GST grouping (continued)

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<tr>
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<tr>
<td>Finland</td>
<td>Yes</td>
<td>Group registration may be granted to taxable persons that supply exempt financial or insurance services and to other taxable persons controlled by financial or insurance companies. Group members must have close “financial, economic and administrative relationships.” All members must be established in Finland. However, Finnish fixed establishments of foreign entities may belong to a VAT group. Group members are treated for VAT purposes as a single taxable person. No VAT is charged on transactions between group members. Members are jointly responsible for all VAT liabilities of the group.</td>
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<tr>
<td>France</td>
<td>Yes</td>
<td>Subject to certain requirements, VAT grouping is permitted under the French VAT law. Effective from 1 January 2012, an election to create a VAT group is allowed, with the election taking effect at the beginning of the following financial year. The VAT group is considered a single entity with respect to the VAT payment. As a result, all VAT liabilities due and input VAT (VAT credit) held by group members are compensated within the group. However, each member must submit its own VAT return for information purposes.</td>
</tr>
</tbody>
</table>
| Germany | Yes| Germany allows group registration for subsidiaries that are “financially, economically and organizationally integrated” into the business of a parent entity. The following general conditions apply:  
  - The parent (or controlling) member of the VAT group may be any type of legal entity, including a corporation, a general partnership or a sole entrepreneur.  
  - A subsidiary (or controlled) member of a VAT group must be a corporation.  

If the integration conditions are met, the subsidiaries and the parent are automatically treated as a group for VAT purposes. The effect of grouping is that the subsidiary is no longer considered an entrepreneur or a separate taxable person. As a result, intragroup transactions are outside the scope of VAT and, accordingly, no VAT is charged. The subsidiary is no longer required to file separate VAT returns, and its transactions are reported through the parent’s VAT return. These effects apply only to domestic supplies between the group entities (that is, supplies within the scope of German VAT). In addition, the effects of the VAT grouping are limited to Germany. VAT grouping does not apply to certain intra-Community compliance obligations. Each subsidiary must have its own separate VAT Identification Number and must file its own European Sales List if it carries out intra-Community supplies. Intrastat returns may be filed on an aggregate group basis by the parent or by each subsidiary separately. |
<p>| Ghana  | No | Ghana’s VAT Act allows for group registration if each member is a registered corporate body in Ghana and has an established place of business in Ghana and if one member controls the others in the group or one company controls all the members of the group. |
| Hungary | Yes| VAT group registration is available for all industries. Companies that qualify as related parties and that have an establishment for economic purposes in Hungary from a VAT point of view may opt for VAT grouping when the participating entities are regarded as a single taxpayer and the group regime applies to all transactions performed by every group member. Practically, this means that supplies made between group members fall outside the scope of VAT, whereas any supplies made outside the group are subject to VAT. In addition, the group members are obliged to file joint VAT returns with the tax authority. |</p>
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</thead>
<tbody>
<tr>
<td>Iceland</td>
<td>No</td>
<td>The Icelandic VAT Act provides that two or more limited companies may be jointly registered. The condition for joint registration is that not less than 90% of the share capital in the subsidiary companies be owned by the principal company that requests joint registration or that of other subsidiaries that also participate in the joint registration. All the companies must have the same accounting year. The joint registration must be in the name of the principal company and is in effect for at least five years. An application for joint registration must be filed with the Director of Internal Revenue no later than eight days before the beginning of the first accounting year following the joint registration.</td>
</tr>
<tr>
<td>Ireland</td>
<td>Yes</td>
<td>The Revenue Commissioners may grant group registration status to companies established in Ireland that are closely bound by “financial, economic and organizational links.” A VAT group is treated as a single taxable person. VAT is not charged on supplies between group members, except for certain supplies of real estate. Group members are jointly and severally liable for all VAT liabilities.</td>
</tr>
<tr>
<td>Isle of Man</td>
<td>No</td>
<td>Corporate bodies that are under “common control” may apply to register as a VAT group. A VAT group is treated as a single taxable person. Group members share a single VAT number and submit a single VAT return. VAT is not charged on supplies made between group members. Group members are jointly and severally liable for all VAT liabilities.</td>
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</tbody>
</table>
| Israel     | No | Consolidated VAT registration is possible for two or more VAT-registered entities that are the following:  
- A company and its subsidiaries  
- Two or more subsidiaries owned by the same parent company  
- A partnership and a partner that holds 50% or more of the rights in the partnership  
The group members share a group VAT number and submit a single monthly or bimonthly VAT report. In addition, each member must submit an annual detailed digital VAT report listing the annual sum of output VAT and input VAT with respect to the other group members and also the sum of output VAT and input VAT with respect to third parties. VAT is not charged on supplies made between group members, unless the VAT is not deductible as input tax. Group members are jointly and severally liable for each other’s VAT liabilities. In practice, they may also be liable for other tax liabilities in certain circumstances. |
| Italy      | Yes| A corporate body that controls one or more other companies may apply to form a VAT group. The controlling company must form part of the group, but it is not necessary for all the companies that it controls to be included. An Italian VAT group is not treated as a single taxable person. The members retain separate VAT numbers, and VAT is chargeable on supplies between group members. The use of a VAT group is effectively an administrative convenience aimed at offsetting VAT payments and repayments from group members. EU entities that are registered for VAT in Italy may be part of an Italian VAT group. |
# VAT/GST Grouping (continued)

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<tbody>
<tr>
<td>Jersey, Channel Islands</td>
<td>No</td>
<td>Group registration is allowed for corporations or other taxable persons that are under common control. One entity must be the representative member. Transactions between group members are disregarded for GST purposes.</td>
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<tr>
<td>Kenya</td>
<td>No</td>
<td>The Kenyan VAT Act allows group registration. However, in practice, group registration is allowed only under special circumstances.</td>
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</tbody>
</table>
| Latvia                    | Yes| Effective from 1 December 2009, VAT groups are allowed in Latvia. The following are the rules for the registration of VAT groups:  
  ▶ The value of VAT taxable transactions of at least one member of the VAT group in the preceding 12 months was LVL250,000 (approximately €355,000).  
  ▶ Each member of the VAT group must be registered for VAT.  
  ▶ A member of a VAT group cannot be a member of another VAT group.  
  ▶ VAT group members can be capital companies belonging to the same group of companies as well as Latvian branches of foreign legal entities, provided that, under the Law on Groups of Companies, the foreign legal entity belongs to the group of companies comprising other members of the VAT group.  
  ▶ The members establishing the VAT group must enter into a valid contract.  
  ▶ The members of the VAT group must be reachable at their legal addresses.  
  ▶ The group members are jointly and severally liable for VAT group tax liabilities. |
| Macedonia                 | No | The Macedonian VAT law allows VAT group registration. Several VAT-registered entities may decide to be registered as a single VAT-registered taxpayer if they have a proprietary, organizational or managerial relationship. In addition, if the tax authorities detect violations of tax principles or the possibility for violations of such principles as a result of a proprietary, organizational or managerial relationship among particular entities registered as separate VAT taxpayers, they can order the entities to register as a single taxpayer. |
| The Netherlands           | Yes| Taxable persons established in the Netherlands (including fixed establishments) may form a VAT group if the members are closely bound by “financial, economic and organizational links.” Since a ruling from the Supreme Court (Hoge Raad) in early 2005, the formation of a VAT group no longer requires a decree from the Tax Office, which is issued after a written request. However, the Tax Office may also issue a VAT group decree on its own accord. For legal certainty, persons meeting the conditions for group registration should inform the Tax Office. 
  
  The effect of VAT grouping is to treat the members as a single taxable person. As a result, transactions between members of the VAT group are disregarded for VAT purposes. Members of a Dutch VAT group may file a single VAT return, or members may elect to file individually. Each member is jointly and severally liable for all VAT due. |
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| New Zealand          | No | Group registration is allowed for corporations or other taxable persons that are “under common control.” For these purposes, a corporation is “controlled” if one or more persons own at least 66% of either the voting power in the corporation or the corporation’s common market value interests. Other taxable persons may form a group if any of the following control conditions is satisfied:  
  ▶ One group member controls each of the others.  
  ▶ One person (outside the group) controls all members.  
  ▶ Two or more persons carrying on a taxable activity as a partnership control the members of the group.  
  Under changes to the GST legislation that were introduced in 2007, retrospective GST grouping is allowed (between 1 October 2001 and 17 December 2006) if the GST group as a whole makes taxable supplies of 75% or more (that is, 75% or more of the total supplies made by the group are subject to GST at the standard rate or zero rate) and if the representative member (see below) of the group is a registered person.  
  Effective from December 2007, certain investment funds may join a GST group with other companies or other investment funds that meet the eligibility criteria. Effective from 1 April 2011, a listed Portfolio Investment Entity can also become part of a group for GST purposes.  
  A group must appoint a representative member. Group members making supplies outside the group must issue tax invoices if requested to do so. The representative group member must account for GST with respect to all group members’ taxable activities and file returns. Group members must adopt the same tax periods and accounting basis for GST purposes. Group members are also jointly and severally liable for all GST liabilities. |
| Norway               | No | The Norwegian VAT Act provides that “collaborating companies” may form a VAT group. Group registration may apply if one or more companies own at least 85% of the capital in each company and if the companies are collaborating. Special issues arise for groups of companies with foreign presence. The VAT authorities must be notified before a VAT group may be formed or dissolved. |
| Papua New Guinea     | No | Subject to certain requirements, two or more companies that have an aggregate of common voting interests of 90% or greater constitute a wholly owned group for the purpose of the GST Act and may apply to the Commissioner General of Internal Revenue to form a GST group. Grouping treats the members as a single entity for certain purposes. In general, all GST liabilities and input tax credit entitlements for group members are attributed to a representative member of the group, and the group submits a single GST return. |
### VAT/GST Grouping (continued)

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| Romania           | Yes| VAT grouping is allowed under the Romanian VAT law exclusively for taxpayers registered with the same tax office. Under the rules currently in effect, at least two taxable persons may form a fiscal group for at least two years if all members meet the following conditions:  
- They are established in Romania.  
- They do not belong to another fiscal group.  
- They use the same tax period.  
- Their capital is held in a proportion of more than 50% by the same shareholders.  
However, VAT grouping is allowed only for VAT reporting (for consolidation purposes). |
| Rwanda            | No | The Rwandan VAT Act allows group registration. However, in practice, group registration is allowed only in special circumstances. |
| Singapore         | No | Businesses under "common control" may apply to register as a GST group. Each member must be individually registered for GST. After members are registered as a GST group, they are treated as a single taxable person and submit a single GST return. Supplies made between members are disregarded for GST purposes. Group members are jointly and severally liable for all GST liabilities.  
A person that is not resident in Singapore or does not have an established place of business in Singapore may be part of the GST group if certain criteria are satisfied. If the group includes a person not resident in Singapore or not having an established place of business in Singapore, the representative member must satisfy additional criteria. |
<p>| Slovak Republic   | Yes| VAT grouping allows financially, economically and organizationally linked domestic taxable persons (including fixed establishments of foreign entities) to form a single taxable person. The VAT group is assigned a single VAT identification number. Supplies between the members of the VAT group are outside the scope of VAT. However, records of such supplies must be maintained for VAT purposes. The Slovak VAT group registration becomes effective on 1 January if the group VAT registration application is filed by 31 October of the preceding calendar year. |
| Spain             | Yes| VAT grouping is allowed under the Spanish VAT law. Companies that belong to the same group must register for VAT individually. |</p>
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| Sweden  | Yes| Companies in the financial sector as well as companies in “an agency relationship” for income tax purposes may form a VAT group. If a VAT group is formed, it is liable for tax if it engages in business that implies tax liability. Only entities with a fixed establishment in Sweden may be part of a Swedish VAT group. A VAT group consists of taxable persons closely connected to each other “financially, economically and organizationally.” All three of these requirements must be satisfied. Here are the applicable rules:  
  ▶ A “financial link” exists between two companies if one company holds more than 50% of the votes in the other.  
  ▶ An “economic link” exists if the companies continually exchange goods or services.  
  ▶ An “organizational link” exists if the group members have some joint administrative functions, such as joint management or joint marketing. |
| Switzerland | No | Legal persons with their seat in Switzerland or commercial units in Switzerland can form a VAT group if they are related as a result of “joint supervision.” The group may include Swiss branches of foreign entities, to the extent that the foreign entities are under the same “joint supervision” as the other VAT group members. Although Liechtenstein is considered to be domestic territory for Swiss VAT purposes (and vice versa), it is not possible to form a VAT group that includes both Swiss and Liechtenstein entities. The tax group must appoint a tax representative to deal with the group’s VAT-related proceedings. The minimum period for which the tax group can exist is one year. Members are treated as a single taxable person with a single VAT number. The following are the significant aspects of grouping:  
  ▶ The VAT group submits a single, consolidated VAT return for all members.  
  ▶ VAT is not chargeable on transactions between group members.  
  ▶ All group members are jointly and severally liable for the group’s VAT liabilities. |
| UK | Yes | Corporate bodies that are under “common control” and are established or have a fixed establishment in the UK may apply to register as a VAT group. A VAT group is treated as a single taxable person. The group members share a single VAT number and submit a single VAT return. No VAT is charged on supplies made between group members. Group members are jointly and severally liable for all VAT liabilities. |
| Zambia | No | Group VAT registration is available for corporate bodies. The businesses must be broadly similar in nature and must be administered by the same management team. |
Ros Barr
Hi, Andrew! Thank you for taking time to talk to me about our new report *Managing indirect tax refunds*. I assume that managing VAT is a big issue for companies in the financial services sector in Europe, such as banks, asset management companies and brokers, because they make supplies that are exempt from VAT/GST. Is that right?

Andrew Bailey
Yes, that is right, Ros. As you know, financial transactions are generally classified for VAT purposes as “exempt without credit.” That means there is no deduction for related input VAT. So, effectively, financial services companies are treated as “final consumers” for these costs, and that obviously has a big effect on the P&L (profit and loss). However, that is not the whole story! Typically, not all financial transactions are exempt — many are actually taxable or exempt with credit. So companies in the sector do have some right to VAT recovery. We call this “partial exemption.” Given the significant cost base for many financial services companies, you can understand why managing input VAT effectively is crucial.

RB
That's interesting! So do you think businesses can manage input VAT more effectively? What would you say are the main issues?

Partial exemption

AB
The key thing is recovering the right amount of VAT. The first thing that financial services businesses need to do, once they have identified the amount of input VAT which is potentially deductible, is to come up with a partial exemption methodology that maximizes the recovery that they are entitled to. The general rule around VAT recovery and partial exemption is that the methodology needs to be “fair and reasonable” and tax authorities test that.

RB
So are there different ways of working out how much VAT you can recover if you are partially exempt? Do different countries apply different rules?

AB
For sure. In Europe, the complexity regarding VAT recovery methodologies varies from country to country. In certain jurisdictions, there is little flexibility in terms of recovering VAT — the partial exemption method is a standard calculation such as a pro rata based on exempt and taxable turnover — whereas other countries are
more sophisticated. For example, in the UK, you can propose using a “special method” which has to be shown to be more “fair and reasonable” than a standard method. It might be based on allocating VAT to certain business units using headcount, management accounts or some other suitable allocation criteria. Once allocated, the actual VAT is deducted using the number of transactions undertaken by that business unit or some other suitable proxy. To give you an example, take value-based fees for derivative transactions. You may have an exempt transaction with a large value and a taxable transaction with a smaller value, but they both consume the same amount of input VAT. So there, a special method is required to give a more equitable result because a standard turnover-based pro rata method would be distortive.

But one mistake I think businesses do sometimes make with partial exemption is to overcomplicate the issue, because once you come up with a method, you have to be able to operate it. You have to be able to ensure that it does not just maximize the VAT that the business is entitled to deduct but that it is also manageable from an administrative perspective. Businesses do change, and you do not want to be in a position that every year you have to change your method because there has been a small change in the business. Obviously, if there is a fundamental change, you need to change your method. But for small changes, it is not efficient.

I have come across situations where doing the VAT return has taken almost a month purely because of the complexity around the partial exemption method.

Presumably, you have to find a balance between getting the best VAT recovery against the cost involved in getting that recovery.

Exactly! Sometimes the cost-benefit analysis that you have to apply is, “If it is going to take the business three weeks to do this calculation every month, is that the most effective use of their time or could they get greater benefits by having a simpler method?”

Notably, technology is playing a role here.

Definitely! The use of technology is changing, and that is opening up a lot of opportunities in this area. I am not aware of any fully automated “golden ticket” partial exemption tool whereby you “push a button” and the amount of VAT recoverable is automatically calculated without the need for any manual intervention. However, I don't think we are far off from that. Technology is evolving whereby businesses are able to start automating part of the partial exemption process. I have no doubt that within the next three to five years – or maybe even before that – as AI (artificial intelligence) capability develops, we will start to see big advances in the automation of the partial exemption process.
The right amount of VAT

*AB*  
I think it is also important to note that a lot of businesses now are introducing data analytics or exception reporting to their compliance process to make sure they are picking up all of the VAT that they are entitled to as well as ensuring that they are not being charged VAT when it doesn't apply. Because the best form of VAT planning is not to pay VAT in the first place!

*RB*  
Great point! Could you expand on that?

*AB*  
Let’s say, for example, if a bank or insurance company outsources part of its process, the question is, to what extent, if any, can those outsourced processes be treated as being either wholly or partly exempt from VAT. If an exemption applies but the outsourcer charges VAT, that is an unnecessary cost. Therefore, I would expect exempt businesses to ensure that they review contracts with their vendors to ensure that the VAT position is clear. Then again, this varies around the EU. If you take the UK, Ireland or Luxembourg, there is quite a wide application of the VAT exemption for financial services, whereas exemption is quite restrictive in other jurisdictions.

What should businesses do?

*RB*  
What would you advise indirect tax directors in this sector to do?

*AB*  
I think there are a number of key actions.

Constant review

*AB*  
Firstly, businesses need to identify that they are being charged the right amount of VAT. If you look at the whole end-to-end process, it normally starts with procurement and then accounts payable (AP) before it is even visible to the tax department. Therefore, it is important to ensure that the AP process is robust to ensure that VAT is correctly identified and to prevent errors. As well as preventative measures, such as staff training, etc., detective measures can be implemented, such as utilizing data analytics to identify exceptions and potential errors. These exception reports can add additional value to the business, i.e., identifying possible duplicate payments.

Procurement is also interesting. When I worked in industry, I worked with the procurement department because it was their job to mitigate costs, and VAT was a cost. We introduced processes for contracts over a certain value whereby before they could get signed I would review them from a VAT perspective. I was looking for areas where VAT exemption could apply, how discounts were treated and so on.

Global contracts

*AB*  
I would also look at the contracting models and again make sure that processes are suitably robust. For example, under global contracting arrangements, processes need to be in place, particularly where costs may be borne centrally and then recharged out to other entities within the corporate group. Regardless of the commercial rationale for having a central contract, if robust VAT processes are not in place, on the one hand, the full amount of VAT may not be recovered centrally, and on the other hand, VAT may not be picked up when the costs are recharged, thereby causing a risk of noncompliance and penalties.
Cost recharges

AB
One other area, in certain businesses—let’s say a corporate finance business—mandates allow them to recharge any cost which has been incurred in the course of providing their services. So if, for example, a bank supplies corporate finance services which are exempt and in the course of supplying those services it is able to recharge any costs incurred, such as legal fees, it is important to ensure that processes are in place to recharge the gross cost, for example the net plus VAT, of the legal fee. This is particularly important where the legal fees may have been supplied cross-border so that any reverse charge VAT is included in the overall cost recharge to the client.

Outsourcing

RB
Is there anything else that you would say businesses in the sector commonly overlook?

AB
This may be a slightly unrelated topic, but the whole discussion about managing indirect tax refunds demonstrates the importance of having strong compliance processes in place, regardless of whether the compliance process is internal or outsourced to a third-party. It is also important to recognize that there is no perfect process; there are always ways to improve – better use of analytics, better reporting management and so on. You have to keep the compliance process constantly under review and businesses need to ask themselves questions: Should we be outsourcing? Can we do this better or more efficiently? Have things changed? Can we make better use to technology? Are we embedded sufficiently within the business to ensure that we are managing indirect tax refunds effectively?
Managing customs duty refund opportunities
More than ever, effectively managing global trade requirements and costs is crucial to obtaining and maintaining a competitive advantage.
Why should you consider duty refunds?

Moving goods across borders is complex and can be costly. Each time a good is imported, it is potentially subject to customs duty, depending on the type of good and its country of origin. Duties are ultimately a bottom-line cost, but they can be reduced, deferred or eliminated through various mechanisms. More than ever, effectively managing global trade requirements and costs is crucial to obtaining and maintaining a competitive advantage. This article will focus on duty refund opportunities.
Free trade agreements

Effectively identifying and using free trade agreements (FTAs) can significantly reduce — or even eliminate — duty costs.

Are you utilizing FTAs?

With over 400 trade agreements in force, optimizing utilization has become a primary focus of many importers. Trade agreements may be bilateral or multilateral, and each has distinct rules.

The FTA climate is changing, as seen with the US withdrawal from the Trans-Pacific Partnership and the potential renegotiation of the North American Free Trade Agreement (NAFTA). Such moves may signal a shift away from large multilateral agreements to more bilateral agreements. Companies should be mindful of how potential changes might affect their overall duty impact.

Effectively identifying and using FTAs can significantly reduce — or even eliminate — duty costs. The benefits of FTAs are optimized when claims for preferential treatment are made at the time of entry. But importers should remember that many agreements permit refunds for a certain time after entry.

The US rules for post-importation claims under certain agreements

Historically, US importers have used various post-importation mechanisms to claim duty preferences under FTAs. These include post entry amendments (PEAs), post summary corrections (PSCs), protests and post-importation claims under 19 USC §1520(d).

However, on 11 August 2014, U.S. Customs and Border Protection (CBP) released a guidance memorandum on “post-importation preference claims.”

The CBP determined that if a preference program does not have a statutory post-importation mechanism (referenced in 19 USC §1520(d)), such as the US-Australia FTA or US-Israel FTA, importers cannot claim post-importation duty preferences through protests. In essence, with certain trade agreements, post-importation claims cannot be made after liquidation, limiting the time frame. (Liquidation is the final computation of duties or drawback accruing on an entry.)

According to the guidance, if FTAs contain a statutory post-importation provision, such as NAFTA and the US-Korea FTA, a 1520(d) post-importation claim remains the “only” appropriate mechanism for seeking preference after importation. If a good would have qualified as an originating good under NAFTA or the US-Korea FTA when it was imported, the importer can file a 1520(d) claim within one year of the importation date.

For FTAs that do not have a statutory post-importation provision, the CBP continued to allow unliquidated entries to be amended with a PEA or PSC prior to liquidation.

Do recent changes to the rules help your company?

On 28 February 2017, the CBP amended the 2014 determination by issuing new guidance. The agency will permit the use of the protest mechanism to submit initial post-importation preference claims if the preference programs do not specifically provide for claims under the statutory post-importation mechanism of 19 USC §1520(d). Thus, companies have more time to pursue duty refunds under FTAs.
Trends in FTA management

Companies are increasingly moving to a shared services approach for FTA management, especially because rules of origin and refund mechanisms tend to be similar across agreements. Developing centralized knowledge in areas such as origin management makes processes more efficient and allows executives to focus on more strategic decisions – critical in today’s rapidly changing environment.

The use of data can also help identify missed FTA opportunities. In the right circumstances, claims can be made after entry if the correct documentation (such as a certificate of origin) is available. Companies can also use their trade data to identify opportunities for future FTA preference.

Footnotes:
2 These FTAs contain a statutory post-importation provision: CAFTA-DR, Chile FTA, Colombia TPA, Korea FTA, NAFTA, Oman FTA, Panama TPA and Peru TPA.
3 These FTAs do not contain a statutory post-importation provision: Australia FTA, Bahrain FTA, Israel FTA, Jordan FTA, Morocco FTA and Singapore FTA, as well as other preference programs, including AGOA, CBERA, CBTPA, Civil Aircraft Agreement, GSP, Insular Possessions, Uruguay Round Concessions on Intermediate Chemicals for Dyes, and Pharmaceutical Products Agreement.

Issue 18 of Tax Insights for business leaders examines recent tax developments, the unique challenges they bring and the steps needed to ensure consistency in the evolving world of tax.

It includes interviews with leading tax officials Martin Kreienbaum, Director General of International Taxation at Germany’s Federal Ministry of Finance and Chair of the OECD’s Committee on Fiscal Affairs, and Akhilesh Ranjan, Principal Chief Commissioner of Income Tax at the Ministry of Finance in India.

Access both interviews at taxinsights.ey.com
Can you participate in a duty drawback program?

Duty drawback is a refund mechanism used globally, typically to promote job creation, manufacturing and export. The specific opportunities and requirements vary by jurisdiction.

Generally, duty drawback programs permit refunds of customs duties, fees and taxes paid in connection with the importation of articles when those articles, or like-kind articles, are exported or destroyed (subject to certain conditions). Exports may include manufactured products in which imported articles, or like-kind articles, were used as a raw material or component.

In the US, the use of drawback dates to the Tariff Act of 1789, but the program has recently undergone significant reform. In February 2016, Congress passed HR 644, The Trade Facilitation and Trade Enforcement Act of 2015. It includes a broad slate of customs and trade reforms for which the CBP and Congress will jointly establish priorities and performance standards. The main implications of the act are detailed below.

Substitution based on the Harmonized Tariff Schedule of the United States (HTSUS) or the Department of Commerce Schedule B Statistical Classification (Schedule B).

Under US law before the act, substitution manufacturing drawback claims were permitted on amounts paid upon importation of merchandise when substituted merchandise “of the same kind or quality” was used in a manufacturing process.

**Duty drawback reform example: automobile industry**

1. Luxury vehicle imported by US company
   - 1,000 cars imported
   - Import value: US$50,000 each
   - (US$50,000,000 total)
   - Duty rate: 2.5%

2. Customs duty paid
   - US$50,000,000 x 2.5% (duty rate) = Total duty: US$1,250,000

3. Economy vehicle exported
   - Eight-digit HTSUS classification code is the same, based on engine size
   - Duty rate: 2.5%
   - Est. duty: US$750,000
   - Drawback amount: US$750,000
   - Net impact: Duty liability reduced by 60%

Managing indirect tax refunds
Substitution unused-merchandise claims were permitted when the imported merchandise and the merchandise exported or destroyed were “commercially interchangeable.” The act simplifies these fact-intensive analyses by allowing substitution between articles with the same eight-digit HTSUS classification.

- **Expanded and simplified time frame.** Under current drawback provisions, an imported or substituted product must be used in a manufacturing process and must be exported or destroyed within three years of the importation date. The manufacturing or unused-merchandise drawback claim must be filed within three years of that exportation or destruction. The act simplifies this time frame by providing a single date from which time is measured — the importation date. And it expands the window for all drawback claims to five years from the importation date.

- **Inclusion of taxes and fees in manufacturing drawback claims.** Under current rules, many claims, including for manufacturing drawback, are limited to 99% of only the duties paid on the imported merchandise. Additional taxes and fees recoverable under substitution drawback were not available for manufacturing claims. The act provides uniformity in authorizing drawback for 99% of duties, fees and taxes paid for all types of drawback.

- **Anti-abuse limitation on refunds.** The act includes a new provision that limits drawback to the lesser of the actual duties, fees and taxes paid on import, or the duties, fees and taxes that would have been paid if the exported article were imported.

As a result, importers that import a high-value item and export a low-value item with the same HTSUS classification generally will have drawback claims limited based on the lower value.

- **Relaxation of transfer documentation requirements.** Current rules require a certificate of delivery to be provided when an importer transfers merchandise to a manufacturer or claimant who ultimately relied on the merchandise in submitting a drawback claim. Claimants are required to submit these certificates as part of their claims. The act removes this certificate requirement, stating that records kept in the normal course of business will be sufficient evidence of a transfer.

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**Who will benefit?**

Companies that will benefit from the new rules include:

- Manufacturers of similar products under different brands in the US and foreign locations
- Importers and exporters of products subject to excise tax
- Commodities traders with international operations

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When will the new provisions take effect?

The provisions were enacted on 24 February 2016, with a notable caveat: no claims can be filed under the new provisions until two years after enactment. The delay is intended to allow time to develop the ability to file drawback claims within the Automated Commercial Environment. Once this delay period passes – on 24 February 2018 – claimants can take advantage of the expanded time frame described above and file drawback claims on imports that occurred after 24 February 2013.

What has changed?

<table>
<thead>
<tr>
<th>Pre-act</th>
<th>Trade Facilitation and Trade Enforcement Act of 2015</th>
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<tbody>
<tr>
<td>1</td>
<td>Substitution rule for § 1313(b) and §1313(b)(2) requires “same kind or quality” analysis based on “commercial interchangeability (e.g., would reasonable hypothetical competitor accept either the imported or the exported good for its primary commercial purpose?)”</td>
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<td>Classification-based substitution permitted between articles having the same eight-digit classification under the Harmonized Tariff Schedule for the US.</td>
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<tr>
<td>2</td>
<td>Manufacturing drawback claims limited to duties, while other forms of drawback (e.g., unused merchandise drawback) permitted recovery of duties, fees and taxes.</td>
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<td></td>
<td>Expanded recovery of duties, fees and taxes imposed at import (including excise taxes) to all forms of drawback claims.</td>
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<tr>
<td>3</td>
<td>Filing of claims allowed for up to three years after exportation.</td>
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<tr>
<td></td>
<td>Filing of claims allowed for up to five years after importation.</td>
</tr>
<tr>
<td>4</td>
<td>Certificate of transfer required as part of claim when importer transfers item forming basis for drawback claim to another party.</td>
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<tr>
<td></td>
<td>Certificate of transfer requirement eliminated: records kept in normal course of business suffice for evidence transfer.</td>
</tr>
<tr>
<td>5</td>
<td>Original signature and certified copies of documents evidencing export required.</td>
</tr>
<tr>
<td></td>
<td>Original signature and certified copy requirements eliminated.</td>
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</tbody>
</table>
Classification

Are you properly classifying your products?

The Harmonized Commodity Description and Coding System (HS) is an internationally recognized and standardized system for classifying traded goods that is administered through the World Customs Organization (WCO). The underlying idea is for all member countries to use the same system to classify goods, including the same descriptive categories, terms and six-digit codes. The HS terms down to the six-digit level are the same for all member countries. At the 8- or 10-digit level, classification is not standardized across countries' tariff schedules.

Correct classification is necessary to properly assess duties. In most countries, incorrect classification can result not only in penalties for the importer but also in overpayment or underpayment of duties. With average rates of 2% to 3%, duties are not an insignificant cost and can directly affect the company’s bottom line. Compliance objectives aside, correcting classification errors can be worthwhile, particularly in jurisdictions where an importer can obtain a refund for overpaid duties.

In the US, PSCs are available to correct classification codes and obtain refunds of overpayments, as long as the entry has not been liquidated. Once liquidation occurs, the computations are considered “final,” and the entry is closed from a duty payment perspective. Classification, rate and calculated duty may also be protested. A customs protest must be filed within 180 days of liquidation. Not all countries provide the same mechanisms or even allow duty refunds. To the extent classification errors are detected, companies should consider available corrective mechanisms. In cases where HTS codes with lower duty rates are deemed correct, the importer may be able to improve its bottom line!
Valuation

Are your products subject to transfer pricing adjustments?

Refund opportunities may be available for companies importing from related parties where transfer pricing adjustments occur. These adjustments may change product pricing. A downward adjustment may result in a duty refund, while an upward adjustment will require additional payment of duties.

The US offers mechanisms for companies to obtain refunds in related-party transactions that are subject to downward transfer pricing adjustments, assuming certain criteria are met. In 2012, the CBP adopted a policy that will accept transfer pricing adjustments under specific conditions. The policy broadens the CBP’s interpretation of what constitutes a formula for the purposes of using “transaction value.” The policy specifically allows post-importation customs value adjustments made under a transfer pricing policy, provided that:

- The transfer pricing policy meets specific criteria stated in the CBP announcement.
- The importer can demonstrate that the transfer pricing policy results in arm’s-length pricing under customs-specific tests.

This policy has enabled importers significantly greater flexibility when making periodic adjustments to transfer prices after importation, including clearly allowing refunds of customs duties when prices are adjusted downward.

The policy outlines actions that importers of related-party products should take to benefit from the new policy.

Apply for the CBP Reconciliation Program

CBP specified that the proposal was intended to apply to importers using the Reconciliation Program. Reconciliation allows an importer to declare a provisional value at import, then adjust to the final value up to 21 months later. Importers must be approved to use the reconciliation program. The ruling also states that if importers claim adjustments outside of reconciliation, “they are expected to demonstrate at the time of entry that the price is arm’s length and to provide supporting documentation.”

Supplement transfer pricing policies

Importers must satisfy five criteria for transfer pricing adjustments to be considered formula-based pricing eligible for transaction value. Several of these criteria must be present in current transfer pricing policy (e.g., “how the transfer price and any adjustments are determined with respect to all products covered by the transfer pricing policy for which the value is to be adjusted”). Transfer pricing policies should be adjusted to clearly meet the customs criteria.

Prepare customs-specific supporting documentation

The 2012 policy dealt with reporting adjustments made under transfer prices that are otherwise acceptable for customs purposes. It did not mean that the CBP would accept transfer pricing studies as support for customs value. Because the proposed policy will make adjustments easier, including those that result in customs refunds, it is more important than ever for taxpayers to supplement transfer pricing studies with customs-specific supporting documentation.
Spotlight

Mexico – customs duty refunds and duty drawback

What are they?
Customs duties are indirect taxes paid on the importation or exportation of goods based on their customs or commercial value. Amounts paid in excess can be requested as refunds or offset against future payable duties. Furthermore, the duty drawback program allows Mexican companies to recover the general import duty paid on importation of:

- Inputs, raw materials, components, fuel and other materials incorporated into an exported product
- Goods returned in the same condition as imported
- Repaired goods

Who is affected?
Only Mexican entities are affected because they are generally the only ones allowed to import or export goods.

What are the impacts?
Improper management of customs duties or failure to request refunds could result in higher costs in the operation because duties are non-cash-flow taxes and are not creditable.
What are the procedures?

Importers or exporters should file the refund request with the tax authorities, along with the customs declaration — and any amendments — and the corresponding certificate of origin (if applicable). The request can be filed through the tax authorities’ website or physically with the corresponding administration.

To offset amounts paid in excess, importers should attach this information to the customs declaration as applicable:

- Taxes and fees offset notice
- The original customs declaration that generated the favorable balance
- The writ, withdrawal or amendment customs declaration
- The certificate of origin or invoice declaration
- Corresponding permits from the Ministry of Economy
- The customs authorities’ resolution on the tariff classification

To apply for the duty drawback program, companies should analyze the origin of the imported goods, the use of preferential duty rates, the destination country of exported goods and, in some cases, the amount of duties paid in the destination country for the importation of the Mexican goods.

To qualify for the program, goods must be exported within a year after they were originally imported, and the official request must be filed with the Ministry of Economy within 90 working days from the date of exportation.

The Ministry of Economy will issue a final resolution within 10 working days. If accepted, the request will be sent to the Ministry of Finance and Public Credit so that it may refund the corresponding amount.
Managing excise duty refund opportunities
Excise taxes apply to specific goods and services, and they are often seen as an inevitable cost of doing business. But these taxes apply to different products in different countries, sometimes at different stages of the supply chain. In particular, as trade globalization, domestic excise duties can become “trapped” as goods and services cross borders. Managing excise taxes and understanding opportunities to mitigate their impact is crucial for all businesses operating in affected industries.

Opportunities to reduce the impact of excise duties also vary between countries. This chapter summarizes some of the common excise taxes, registration requirements and refund opportunities in various jurisdictions worldwide.
What are excise duties?

Excisable products typically have negative effects on health or the environment, or they require long-term national public investment to produce. Common excisable products include gasoline, tobacco and alcohol. Many countries around the world are adding junk food, pollution, landfill, plastic bags and air travel to the list. In effect, these duties are a form of payback for the cost to society of dealing with the harmful effects to society. The main purpose of most excise taxes is to raise revenue; however, increasingly they are also being used to influence consumer behavior.

Excise duties typically apply at a single stage of the supply chain (such as production or at retail sale) and they are not generally available for offset at later stages in the chain. They may apply as a percentage of the value of the goods or services or at a fixed rate (such as a charge per liter or per pack of cigarettes). For imported goods, duties are generally imposed at the time of importation to level the playing field between foreign and domestic products.

Read more about global trends in excise duties

*Indirect Tax in 2017* details the findings of an EY 2016 survey of indirect tax subject-matter professionals about existing and upcoming excise taxes being imposed worldwide. It features an interview with Professor Sijbren Cnossen, Erasmus University, Rotterdam, and discusses tax policy options to support climate change and sustainability.

Read more at ey.com/indirecttax2017
Country insights

Australia

Excise duties are applied to some goods manufactured in Australia, including petroleum products, alcohol and tobacco. Excise-equivalent customs duties are applied to excisable goods imported into Australia. Excise does not generally apply to exported goods. The rates of excise are legislated in Australia via the Schedule to the Excise Tariff Act 1921.

For crude oil and condensate production from coastal waters, onshore areas and the North West Shelf project area, the rate of excise duty can range from 0% to 55%, depending on annual production and whether the oil is considered old, intermediate or new. The maximum rate for new oil (discovered after 1975) is 30%. In all cases, the excise liability is calculated by applying the relevant crude oil excise rate to the volume weighted average of the realized free-on-board price. The first 30 million barrels of crude oil and concentrate from a field are excise-free. For projects that have a Petroleum Resource Rent Tax liability, any excise payable is effectively creditable through a grossed-up deduction.

Registration

Manufacturers of excisable goods are required to be licensed, as are entities that warehouse such goods. The Australian Taxation Office (ATO) is responsible for granting excise manufacturer and warehouse licenses and for collecting excise duties.

Duty recovery

For most goods on which excise duty has been paid, a duty drawback claim can be made if the goods are subsequently exported. Such claims must be submitted to the ATO within 12 months of the export date.

Entities that are seeking a drawback do not require any form of registration or permanent establishment in Australia.

The excise duty on most liquid fuels, including petrol and diesel, is AU$0.401 per liter as of 1 February 2017 and is subject to indexation each February and August. If these fuels are acquired in Australia for a business activity, up to 100% of the excise duty can often be recovered as a fuel tax credit. To claim these credits, entities must be registered with the ATO for both fuel tax credits and goods and services tax.

Duty recovery for fuel exported from Australia is also secured via a claim for fuel tax credits. Credits are claimed in periodic activity statements lodged with the ATO. Entities can claim credits attributable to periods going back four years.

For unregistered entities, any excise paid on liquid fuels that are subsequently exported can be claimed as a drawback, as described above.
Belgium
The EU has harmonized excise legislation for alcohol, tobacco and energy products – the so-called Community Excise Goods. Harmonization includes monitoring intra-Community movements and maintaining minimum excise duty rates for these goods.

Member States can levy other indirect taxes on excise goods for specific purposes. These taxes must comply with EU rules governing the determination of the tax base, the calculation of the tax, chargeability and the monitoring of the tax – but not the provisions on exemptions. The levying of such taxes may not, in trade among Member States, give rise to formalities connected with crossing frontiers.

In Belgium, national excise duties apply to nonalcoholic beverages and coffee, and packaging taxes apply to reusable and nonreusable packaging of both alcoholic and nonalcoholic beverages.

Registration
Most excise duty acts provide for two means of registration. The company can be registered as either an authorized warehouse keeper or a registered trader. Broadly, manufacturers should be registered as authorized warehouse keepers, while companies receiving goods from foreign countries should be registered traders. Exceptions apply, and sometimes intermediaries or companies receiving taxable goods from foreign countries can or must be registered as authorized warehouse keepers.

Refunds
Refunds or remissions of excise duties are possible:
- If excise goods have not been and will not be consumed in Belgium
- If excise goods are destroyed under the supervision of the authorities
- If excise goods are exported outside the EU
- If the excises paid relate to excise goods for which no excise duties are due, or if the excise duties are higher than legally due
- If excise goods are accidentally released for consumption

In Belgium, excise duties can be reclaimed within three years if an excise return has been filed for the concerned products. Duties can be refunded only if they exceed €10 per excise return and per product category.

Refunds are also possible if products are used for certain purposes in Belgium (e.g., professional diesel).

Refund example cases:
1 Master data problem at a large Dutch retailer active in the Belgian market – during new product introductions, products were wrongly identified as excisable.

2 Distributor of chain saw products in the Benelux market, including certain fuels for chain saws and other power tools. Goods were transported from Germany to Belgium under the excise suspension regime and were put in free circulation through the submission of an excise return in Belgium. Some of these fuels were then transported to Luxembourg to be sold to customers there. Because of the general rule that excise products are dutiable in the country of consumption, excise duties were also due in Luxembourg. A spontaneous disclosure has been submitted in Luxembourg for the fuel quantities delivered there for the past three years. Because the distributor has also paid Belgian excise duties for the fuel delivered in Luxembourg, a refund request has been submitted for the Belgian duties.

3 A refund request for excise duties on professional diesel fuel for an Eastern European road transport firm. Because of the firm’s internal reorganization and its diverse daughter companies, Belgian excise authorities had doubts about the validity of the refund requests.
Refunds

The total IPI paid on purchases is offset against the total IPI due on sales. The amount of tax due by the company (considering the IPI due or credit in all its establishments) must be calculated and paid monthly.

On import operations, the IPI generates an amount with payment due at the moment of customs clearance. The same amount is usually regarded as a credit and added to the month’s balance to offset future operations. Credits are not allowed for IPI, except in the case of acquisitions or imports of fixed assets and goods for consumption.

Denmark

Denmark is in the driver’s seat on excise duties. A significant excise duty is charged on many products to reduce the use of certain goods, either for health or environmental purposes or for fiscal purposes.

Traditionally, the leading political consideration has been health (e.g., alcohol and tobacco). Because of the oil crisis in the 1970s, excise duties on energy were used to limit consumption of petrol, electricity, etc.

In recent years, environmental excise duties have also emerged. Some of what are now known as environmental duties were introduced at the end of the 1970s as purely fiscal duties – almost without mentioning the word “environment.”

Today, Denmark has excise duties on the following goods and services, among others: alcohol, tobacco, cigarette paper, chocolate and sugar products, nuts, ice cream, coffee, tea, mineral oil products, coal, electricity, natural gas, carbon dioxide, packaging material for beverages, plastic and paper bags, disposable tableware, PVC foils, piped water, pesticides, chlorinated solvents, nickel-cadmium batteries, nickel-cadmium accumulators, sulfur, nitrogen oxides, antibiotics and growth stimulators, PVC, phthalates, filament lamps and electronic fuses.

These goods are headline items. Almost all the legislation includes narrower descriptions of which goods are subject to excise duties. For example, only the packaging of certain beverages is subject to package tax.

Foreign companies might be subject to excise duties if they are established in Denmark – e.g., if they have a Danish subsidiary or branch. Foreign companies can also be subject to Danish excise duties if they buy and resell goods subject to excise duty in Denmark.

Registration

Most excise duty acts provide for two means of registration. The company can be registered as either an authorized warehouse keeper or a registered trader. Broadly, manufacturers should be registered as authorized warehouse keepers, while companies receiving goods from foreign countries should...
be registered traders. Exceptions apply, and sometimes intermediaries or companies receiving taxable goods from foreign countries can or must be registered as authorized warehouse keepers.

Refunds
Excise duties on energy products can be refunded if the products are used for certain purposes in Denmark, as defined in the regulation, or if the products are exported. Excise duties on other products can be refunded if the goods are exported, the excise duty can be deducted on the excise duty return.

Germany
Excise tax regulations are largely harmonized within the European Union. Therefore, most excise duties in Germany relate to products that are taxed in the entire EU: energy products, electricity, alcoholic beverages (especially spirits, sparkling wine and beer) and tobacco. However, some excise duties apply only in Germany: duties on “alcopops” (sweet drinks containing spirits) and coffee.

Registration
German excise duty law requires registration for at least the following activities involving the abovementioned goods: importation, production, modification, distribution and exportation. Companies also need a registration to apply duty suspension regimes, which come in two basic types:

1. Companies can register for an excise duties warehouse to store their goods without excise duties arising.
2. It is also possible to transport goods, with excise duties suspended, through the Excise Movement and Control System or as a registered consignee or consignor in the EU.

Refunds
The German regulations provide various refund possibilities for excise duties. Most are based on European directives and have been transferred into German national law. Depending on the type of product, the different legal acts require specific prerequisites. Refund possibilities with electricity and energy taxes are especially relevant for many companies.

The German Electricity Tax Act, as well as the German Energy Tax Act, allows refunds of electricity and energy taxes paid up to 100%. For some refunds, the applicant must fit the definition of a “producing entity” under the law. These companies can obtain extensive refunds if they use the electricity or energy for operations. For other refunds, the processes conducted with the electricity or energy are the deciding factor. To apply for refunds, the company must provide comprehensive information on both the applicant as well as the use of the electricity or energy. Thus, refunds usually require considerable administrative effort.

Italy
The Italian excise duty system provides five categories of products subject to excise duties by European laws: energy products, natural gas, electricity, alcohol and alcoholic beverages, and manufactured tobacco.

In Italy, lubricant oil and petroleum bitumen are subject to the consumption tax – i.e., a non-harmonized excise duty.

Refunds
The most important case of reimbursement concerns intra-EU selling or export of goods subject to excise duties not covered by a customs suspension procedure. The main principle of the excise duty and consumption tax mechanism holds that every product subject to the duty must be charged only in the EU Member State of consumption, regardless of where it is produced or imported, to avoid double taxation.

Other facilitations
Different types of facilitations – exclusions, exemptions and reductions – are applied in advance or through the reimbursement mechanism.

An excise duty exclusion for steel and coal is possible for metallurgical and chemical reduction purposes and for electricity when it accounts for more than 50% of the cost of producing the product.
In Mexico, excise tax must be paid on the importation, sale or rendering of the following goods and services:

- Beer and other alcoholic beverages
- Alcohol
- Cigars and tobacco
- Automotive fuels
- Energy drinks
- Flavored beverages
- Fossil fuels
- Pesticides
- High-calorie foods (junk food)
- Commission, mediation, agency, representation, consignment and distribution of the abovementioned goods
- Betting, lottery draws and similar games
- Public telecommunication networks

Excise tax costs
The taxes apply to both Mexican and foreign entities that conduct these activities. An excise tax credit is any amount derived from these transactions that’s payable in a taxable person’s favor. Excise tax applies only to certain sectors and activities, so if an entity purchases goods or services subject to tax but does not conduct taxable activities, the amount paid represents a cost in the operation. As with VAT in Mexico, foreign residents cannot claim an excise tax refund.

Applying for an excise tax credit
To request an excise tax refund, the claimant should:

- Confirm that all e-invoices received from suppliers and issued by the company are correct, as well as verify that the digital stamps are in force
- Analyze the reconciliation of bank statements and wire transfers against the transactions of the main suppliers that triggered the input excise tax
- Review the excise tax declaration
- Compile a file with the relevant data and documentation
- Submit the refund claim to tax authorities by filling out the relevant template and annexes
- Follow up with tax authorities by attending meetings to explain the assessment of the credit balance and providing supporting documents and workpapers

Exemptions are also granted to excise goods intended for the armed forces of members of the North Atlantic Treaty Organization; for uses other than fuel engines or heating fuel; for oil for aircraft and vessels employed in air and sea navigation; for vegetable oil used for agricultural purposes and for the production of electricity; for magnesium production from seawater; and for energy products used in blast furnaces for production processes.

Reductions apply to diesel and gasoline used for agricultural purposes; to natural gas used in construction sites; and to natural gas, liquefied petroleum gas, diesel, coal, brown coal and coke used for direct or indirect production of electricity by authorized subjects.
The Netherlands

The Dutch excise legislation is based on EU law, which largely grants autonomy to Member States to provide for refund opportunities in their national excise legislation. As a trading nation, the Netherlands used this opportunity to provide companies with general and specific excise refund opportunities.

The excise-taxable products in the Netherlands are mineral oils (e.g., petrol, diesel oil and liquefied petroleum gas), products containing alcohol (e.g., beer, wine and intermediate products such as sherry and port) and tobacco used for smoking (including cigarettes and cigars). Other product-specific duties apply to, for example, nonalcoholic beverages (fruit and vegetable juices, mineral water and lemonade), coal and gambling. However, these products are not subject to Dutch excise duties but to product-specific indirect taxes.

Excise duties on mineral oils account for about 70% of total excise revenue in the Netherlands, making mineral oil the most important excisable good. The Netherlands acts as a trading hub within the EU, so many foreign companies shipping mineral oils via the Netherlands might be subject to Dutch excise duties.

Registration

In the Netherlands, only companies that apply an excise license, e.g., an excise warehouse, need to register. In principle, the license holder can store products in an excise warehouse without having title to the goods.

Refunds

Broadly speaking, the Netherlands offers two kinds of refund opportunities. The following is a high-level overview that does not account for the conditions that must be fulfilled to apply for refunds.

Dutch legislation provides for general refund opportunities that apply to all excise-taxable products. Refunds are given for excise-taxable goods that are irretrievably lost, destroyed under customs supervision or shipped to another country or an excise warehouse.

Excise-taxable goods intended for specific use in diplomatic or consular relations, by international organizations, by armed forces or under an agreement with non-EU countries or international organizations may also be subject to refunds.

Dutch legislation provides for product-specific refund opportunities, mostly for mineral oils. For example:

- Refunds are available on alcoholic beverages if they are used to produce food or medicine, or if the products are not used for human consumption.

- Refunds are provided if cigarettes and smoking tobacco contain components other than tobacco and have been solely used for medical purposes.

- Refunds are provided for mineral oils used to produce electricity in a plant or used in a blast furnace or as fuel for seagoing vessels or inland barges, except those for private pleasure, or for aircraft, except those for private pleasure.

- Businesses can also apply for a refund if the mineral oils are not used as heating fuel, motor fuel or an additive in motor fuel.

- Of growing importance is the refund that applies to mineral oils used for the sale or heating of biomass.
Refunds

Three key opportunities exist for excise tax refunds on motor fuels and trucks.

1. Use taxable fuel in a tax-exempt manner, such as clear diesel used on a farm, diesel used in construction equipment and alternative fuel used in forklifts. On a federal and state level, fuel used for anything other than propelling a vehicle down the road generally results in a tax refund. That same theory can be applied to the airline industry for fuel burned prior to flying.

2. Utilize income inclusion rules. From the mid-2000s until 31 December 2016, the sale and use of biodiesel blends and alternative fuels (compressed natural gas, liquefied natural gas, propane, etc.) generated a credit against excise tax liability. The credit was larger than the amount of tax imposed per gallon, resulting in an overpayment for many organizations. The amount of the credit above the excise tax liability is not an item of gross income and should not be included in income. Alternatively, in Sunoco, Inc., v. United States, No. 15-587T, the Federal Claims Court concluded that excise tax credits allowed under Section 6426(a) against the excise tax liability must be treated as a reduction in the claimant’s excise tax liability under Section 4081. For years open under the statute, a company might be able to file for refunds where it included certain refunds in gross income.

3. Seek refunds of the 12% retail excise tax imposed on trucks and trailers that weigh over 33,000 pounds if the truck or trailer is deemed to be “mobile machinery” or has another non-transportation function. Various exemptions — such as modifications to a chassis, a special design for off-highway use and a non-transportation function — would allow claimants to seek a refund of the federal excise tax paid on the truck or chassis.

US

The US imposes federal, state and local excise taxes on various products, including fuels (such as diesel, gasoline, kerosene and certain types of natural gas), alcohol, tobacco, air transportation, heavy vehicles and trucks, reinsurance, medical devices (currently under suspension), tires, firearms, minerals and sugary drinks (currently city level only).

Businesses pay about one-quarter of all state and local excise taxes on their purchases of operating inputs. Further, businesses have seen a 6.6% annual growth rate in their state and local excise taxes over the past five years – a combined 30% increase since 2010. In the most recent information, from 2015, state excise taxes make up about 85% of state and local business excise taxes.

Registration

Broadly speaking, registration is required for the import, production, refining, distribution and export of certain products. Registration is often required to claim certain federal excise tax refunds. Operating without the proper requirements can lead to significant penalties (e.g., US$10,000 for the initial penalty plus US$1,000 per day for each infraction).
Indirect tax refunds — the future is coming
Nowadays, any discussion on the future of indirect taxes is almost bound to include the terms “robotic process automation” (RPA), “artificial intelligence” (IA), “the Internet of Things” (IoT), “machine learning” and “blockchain.” Relatively obscure concepts only a few years ago, these technologies are increasingly providing solutions to a range of challenges facing governments and global businesses. They have the potential to streamline and accelerate business processes, increase cybersecurity and reduce or eliminate the roles of trusted intermediaries and centralized authorities.
Most of these changes may still be in the future, but increasingly, in the digital economy, the future is now. Applications are already being explored and are likely to be adopted in the near future. As they prove their worth, the rate of adoption is only likely to increase, and new and surprising uses will emerge.

What will be the impact for indirect tax refunds?

As these technologies become a reality, they will influence a whole range of taxes, including VAT/GST, customs duties, environmental levies and excise taxes that are closely linked to business transactions. Developments that alter how goods and services are manufactured, traded, delivered and paid for will also transform how and where indirect taxes are applied, reported and collected. Will your VAT/GST returns be prepared and audited by robots? Will smart contracts decide where insurance taxes are due and remit them automatically? Will distributed ledgers remove the need for invoices? Will governments impose cryptocurrencies to collect and refund cross-border VAT/GST? Will customs declarations be filed automatically by container ships and not by customs brokers? Will governments impose cryptocurrencies to collect and refund cross-border VAT/GST? Will customs declarations be filed automatically by container ships and not by customs brokers? Will customs declarations be filed automatically by container ships and not by customs brokers?
Robotic processing and artificial intelligence

In recent years, industrial robots have transformed manufacturing by increasing production and improving quality. RPA software is now doing the same for business processes and back-office work.

Can RPA transform indirect tax refunds?

RPA technology has the potential for widespread use, and is being applied not only in a range of industries but also in all parts of the organization. Any process where people perform high-volume, highly transactional functions could be a contender for RPA software, including finance, procurement and supply chain management. Not surprisingly, this new technology is fast finding its way into tax and accounting functions and revolutionizing many aspects of indirect tax compliance, including identifying and processing refunds, credits and rebates.

Using trained robots to prepare VAT/GST returns and refund applications or to identify accurate commodity codes for customs declarations is likely to cut costs by reducing processing times. It may also allow staff to be deployed more effectively across the tax return cycle or to dedicate time and resources to “value-added” functions, such as supply chain, that maximize free trade opportunities.

Equally important, RPA can also greatly improve the accuracy of reports, even if entries depend on complex decisions (e.g., about the VAT/GST recoverable on a foreign invoice). Robots do not make mistakes, and they can be programmed to become smarter and learn from past decisions.

Robots – the tax advisors of the future?

Robots may move from being the “doers” to being the “informers” or “research assistants” of the tax function, enhancing the quality of tax planning decisions made by their human colleagues. Developments in how machines process natural language, retrieve information and structure basic content mean that RPA could provide answers to employees on a range of indirect tax topics. This capacity to retain and retrieve information and to answer human questions could be particularly beneficial for shared services center staff who must prepare, submit and review declarations and filings for multiple jurisdictions.

Challenging where refunds are processed and by whom

RPA will challenge decisions about how and where indirect tax refund claims are prepared and by whom. The cost-benefit analysis for any claim is likely to change, putting new opportunities on the table to improve refunds and reduce recovery times. Should you outsource or should you bring these processes back onshore? Can heightened accuracy remove concerns that a centralized shared services center may not be able to cover multiple jurisdictions? Can intelligent robots programmed with specialist knowledge identify part numbers to allow more accurate commodity codes that reduce duty bills?

Undoubtedly, as RPA brings more advanced solutions to businesses around the world, tax functions that adopt automation, whether in-house or offshored, will cut costs, drive efficiency and improve quality.
Blockchain

Tax and customs administrations demand high levels of accuracy for accounting and reporting to support indirect tax filings and customs declarations, especially where credits, rebates and refunds come into play. These demands can create significant compliance obligations for taxpayers and cross-border traders, and the need for detailed audits can lead to significant delays. The speed, accuracy, and transparency of blockchains could alleviate these burdens for taxpayers seeking refunds by decreasing the risk of fraud for tax and customs administrations.

The idea behind blockchain is not new, but decentralized, distributed ledgers have become possible only recently, thanks to advances in technology, computing capacity and connectivity. As computing power and connectivity increase exponentially, the applications for blockchain are likely to increase and the costs will decrease. Many blockchain applications will go from being a good idea for the future to being a practical daily reality. Although these applications are not yet available in the world of indirect tax, it seems likely that using blockchain technology may one day be common – even mandatory – for accounting for and collecting indirect taxes.

Blockchain indirect tax regimes

Tax and customs administrations could create blockchains to transmit indirect tax data and payments to and from taxpayers and importers to government portals. Tax administrations around the globe are already demanding real-time information from businesses to assess and support their VAT/GST liabilities, for example. Blockchains could greatly facilitate the speed, accuracy and ease of collecting indirect tax data, improving compliance while reducing the cost of enforcement.

Indirect tax blockchains could involve taxpayers in a single jurisdiction, or they could cross multiple jurisdictions (such as the European Union or Gulf Cooperation Council). For the blockchain regime to be most effective, participation should be compulsory for all businesses. As a first step, however, participation could be imposed on businesses of a certain size, or businesses could be incentivized to sign up because of reduced compliance obligations or improved refund times. The blockchain’s transparency would allow businesses to verify the authenticity of others in the supply chain, mitigating the risk of suffering blocked input tax or additional tax payments. However, it could also raise concerns about privacy and commercial sensitivity.

What is blockchain?

A blockchain is a distributed ledger of transactions. Like a traditional ledger, individual transactions (unique blocks) are added to the ledger (the chain) and never removed. A blockchain is a type of database for recording transactions – one that is copied to all the computers in a participating network. If you have access to the latest block, it is possible to access all previous blocks linked together in the chain. A blockchain database retains the complete history of all assets and instructions executed since the very first one, making its data verifiable and independently auditable.
Improving accuracy, countering fraud

Collecting the right amount of indirect tax depends on the honest reporting of accurate information, often in real time. Taxpayer errors, lack of data, negligent accounting and fraud can all have a significant impact.

Fraud is particularly common in systems where supply recipients have the right to deduct VAT/GST on their purchases and costs from the VAT/GST payable. The purchaser may even be entitled to a refund if the tax receivable exceeds the tax payable. A valid VAT/GST invoice serves like a check on the tax office. This mechanism can attract fraudsters. The large sums lost in the Missing Trader Intra-Community fraud in the European Union are just one manifestation of the danger that bad-faith traders can pose to an entire system, with VAT loss through fraud in the EU amounting to an estimated €100 billion per year. Customs fraud also takes a toll. Masking the true origin of goods could prove very profitable, for example, because they might benefit from unjustified preferential import duties or free trade agreements.

Features of blockchain

- **Secure**
  - Strong cryptography makes certain that changes can only be initiated by certified parties
  - All changes must be validated by participants collectively

- **Immediate**
  - Data is updated in real time

- **No intermediary**
  - Distributed ledger
  - Doesn’t require intermediary to authenticate or settle transactions
Cryptocurrencies
Governments could require all taxpayers to pay indirect taxes and receive indirect tax credits or refunds using a government-backed cryptocurrency (such as VATCoin) based on blockchain technology.

Verified documentation
Indirect tax declarations depend on accurate and reliable documentation. These documents play a vital role in supporting entitlement to rebates, credits and refunds, such as free trade agreement duty reliefs and refunds for input tax. Customs declarations and export controls, for example, depend on a range of commercial and transport documents to prove the origin and destination of goods, their end use, and their composition or classification. The amounts reported as payable (or claimable) on VAT/GST returns must be backed by valid tax invoices that clearly identify the goods or services supplied, the parties to the transaction, the value of the sale, and when and where it took place.

A blockchain regime could require every tax document to have a digital fingerprint (derived through the indirect tax blockchain regime). The fingerprint would immediately identify that the block under scrutiny is permanently linked to the previous and subsequent blocks. The entire history of the commercial chain, forward and backward from this transaction, could be followed. This scrutiny could be done by a tax official in an office, by a robot or by a customs officer at a border. Anyone connected to an approved tax-auditing program could immediately pull up the entire commercial chain for an item from a valid invoice or other commercial document.

Automatic offset of output tax and input tax
The use of immediately verifiable information could allow taxpayers to support claims for VAT/GST deductions and customs rebates and reliefs in real time.

As we have seen, fraudulent and incorrect claims for input tax deductions pose a severe threat to many VAT/GST systems. Currently, a VAT/GST payer who has a valid tax invoice or customs declaration (or what appears to be a valid document) is entitled to offset the VAT/GST shown on the document as input tax against VAT/GST charged on sales (output tax). Or the payer can claim a refund if there is no output tax to offset. This applies even if the supplier has not paid the tax due. The tax administration may permanently be out of pocket if the document is false or if the supplier who issued it acts in bad faith and does not pay the output tax shown. Using a blockchain to automatically collect and offset tax in the chain could remove this risk entirely. The output tax could be taken by the tax administration when the transaction took place, and the right to offset input tax could be verified immediately but only once the tax was paid.

Footnote:
1 The term “VATCoin” was first used by researchers Richard T. Ainsworth, Musaad Alwahaibi and Mike Cheetham in several publications in 2016 and 2017.
Smart audits

A major source of cash flow delays in receiving refunds and benefiting from rebates arises from the time needed to verify taxpayers’ claims. The digital revolution is transforming how tax administrations collect and exchange data and how they perform audits, reducing the risk of fraudulent claims and shortening the time that good-faith taxpayers must wait for refunds.

Data analytics already helps tax and customs administrations to scrutinize taxpayer data in real time and identify incorrect or anomalous transactions. As this technology becomes cheaper, indirect tax administrations are likely to increase their use of artificial intelligence and RPA to facilitate their risk analysis. These technologies will allow them to audit more transactions and carry out more effective audits with fewer trained auditors and in a fraction of the time needed previously, even as transactions take place. Any indirect tax blockchain regime would provide high levels of transparency and would likely be linked to other government sources. Auditors would have immediate access to large numbers of public and private databases, including information about the parties to the transaction and other comparative data. Statistical anomalies could be identified in real time, and the relevant authorities (including in other countries) could be alerted.

In this environment, taxpayers may not even be aware that an audit is happening until they receive an assessment or an authorization for their claim. Therefore, they must assume that all refund claims will be subject to scrutiny.
Managing indirect tax refunds

The future is coming
A US multinational company’s tax team was spending significant time each month making sales and use tax determinations, leaving little time for review. This resulted in an error rate of approximately 40%. The company was being overcharged sales tax by multiple suppliers when it should have benefited from exemption.

We identified that RPA could streamline the large number of low-volume transactions processed by the company each month. We held a workshop with the tax function to develop a prioritized list of processes to be automated. We also linked the US project to a similar program being undertaken in Latin America.

In eight weeks, we put a “bot” in production that downloads source data, identifies erroneous tax codes, downloads invoices and prepares sales and use exemption certificates. The tax team reviews and validates each case before submitting the tax exemption certificates to relevant suppliers.

The benefits of introducing RPA included:

- Improved accuracy, mitigating tax compliance risk
- Reduced sales and use tax costs
- Increased efficiency, reducing compliance costs
- Enhanced job satisfaction, because tax team members could focus on higher-level activities, accelerate their learning and demonstrate their function’s value to the company as “pioneers” of innovation
From review to renew: adopting a strategy for indirect tax refunds
Actively managing indirect tax costs should be a central part of any taxation strategy. Even if you choose not to claim VAT/GST refunds or reduce customs duty costs, those decisions should be based on deliberation and knowledge of your options and the likely outcomes.
Where are you on the journey?

The first step on the journey toward an effective refunds strategy is to identify where you are on the road. You can then map where you want to be — and the best way to get there.

With indirect tax management, all roads do not lead to Rome! The best approach can vary greatly from business to business, and finding it will depend on many factors, such as the taxes involved, the countries where you operate, your business model, your technology and the cost of finance. The most effective approach often depends on finding the right balance between the value of refund opportunities and the costs of obtaining them.

An example of a road map for dealing with VAT/GST refunds

- **Value**
  - Leading edge: Utilizing in-house technology (e.g., ERP systems or a data warehouse) or third-party technology (e.g., data analytics, robotics and workflow tools).
  - Established: Outsourcing claims to a third-party service provider.
  - Basic: Not claiming VAT/GST on the basis that the process is too difficult administratively and not cost-effective.

- **Efficiency**
  - Focusing on larger categories of spend as the reclaim process is highly laborious and ineffective from a cost perspective (the 80/20 rule).
Developing a refunds strategy road map

You may be at different stages of the journey for different indirect taxes. You may already have fully automated processes to identify and track domestic VAT/GST credits, but you may not take advantage of all your opportunities to use free trade agreements or to recover foreign VAT/GST. An effective strategy may require different approaches for different taxes, depending on the circumstances. In all cases, you will need to assign responsibilities and gain visibility into your tax issues and opportunities. You can then decide how to act and adopt systematic processes, measures and controls to review, implement and monitor what you are doing. And you will need to keep those decisions under review to take into account disruptions in business models, advances in technology, and changes to tax laws, obligations and regulations.

Questions to consider

- What taxes do you manage?
- Where do you stand on each now?
- What is the leading practice?
- What are your peers doing?
- What is “good enough”?

Identifying the key risks and opportunities, resources and actions for each tax

<table>
<thead>
<tr>
<th>Review</th>
<th>Plan</th>
<th>Approve</th>
<th>Act</th>
<th>Monitor</th>
<th>Renew</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identify the indirect taxes you manage and the significant risks and refund opportunities for each. Identify where you are and where you want to be.</td>
<td>Consider the best options and the likely benefits and cost. Compare alternatives. Make recommendations.</td>
<td>Agree on the strategy and validate the resource needs, benefits and actions to take. Set key performance indicators. Obtain buy-in from other parts of the business.</td>
<td>Implement your strategy. For example make retrospective claims, restructure operations and implement automation.</td>
<td>Implement appropriate controls to monitor performance. Measure cost and benefits against expectations.</td>
<td>Keep your strategy under review to take into account changes (e.g., in the business, in tax and customs legislation, and in technology).</td>
</tr>
</tbody>
</table>
Taking technology into account

A successful indirect tax recovery exercise is likely to hinge on your ability to deal with large numbers of transactional line items, contained in large data files. The size of the task can seem daunting, and undertaking it may not appear cost-effective. An indirect tax refunds strategy, therefore, is likely to include the evaluation and implementation of tax technology. This may include tools supplied by third-party vendors, such as tax reporting or workflow management technology. And you may want to explore how to enhance and adapt in-house tools such as enterprise resource planning (ERP) systems. Objectives may include improving tax data quality, automating tax reporting, shortening processing times and enhancing tax business intelligence to drive efficiencies and decrease risks.

Kevin MacAuley, EY EMEIA Indirect Tax Leader, and Rosie Higgins, Indirect Tax Director, Ernst & Young LLP, UK, discuss how to manage indirect tax refunds, costs and credits including:

- Why indirect tax refunds are a hot topic
- What we see clients doing
- How VAT costs interact with base erosion and profit shifting
- How to drive VAT out of working capital and mitigate the impact of sticking VAT

Watch the video at ey.com/indirectrefunds
Some places to explore

The first step in identifying hidden costs is to know where to look. Gaining visibility into what the business incurs and how it handles the amounts is key. This can require a thorough analysis of the company’s ERP data, but you may need information from other reporting systems, even third parties. In earlier chapters of this report, we identify specific considerations for recovering foreign VAT/GST, dealing with domestic tax credits, and rebating and reducing customs duties and excise taxes.

The following table gives some examples of areas where trapped and hidden VAT/GST may be found.

<table>
<thead>
<tr>
<th>Area</th>
<th>Questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Travel and entertainment</td>
<td>Can we identify the VAT/GST? Can we claim it? Is the documentation good? Is the foreign VAT/GST claimed?</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>Have we missed claims or overclaimed through processing errors? Is our documentation good? Are any accounts showing VAT/GST where we wouldn't expect it? How long does it take to authorize invoices? Do delays damage our right to recovery? Do delays hurt our cash flow?</td>
</tr>
<tr>
<td>Intercompany charges</td>
<td>Have we been charged VAT/GST? Why? Is it really chargeable? Is it recoverable? Can we mitigate all or part of the tax?</td>
</tr>
<tr>
<td>Foreign VAT/GST</td>
<td>Why have we been charged? What are the goods or services? Is the VAT/GST charge correct? Is it recoverable? Do we have a VAT/GST obligation in this country?</td>
</tr>
<tr>
<td>Bad debts</td>
<td>Are we reducing our VAT/GST output tax for bad debts? Do we have a process? Are we doing this in every country?</td>
</tr>
<tr>
<td>Global contracts</td>
<td>Is the correct VAT/GST being charged? Is it being passed on? Is it being recovered?</td>
</tr>
<tr>
<td>Profit and loss (P&amp;L)</td>
<td>What unexpected VAT/GST costs are attached to expenditures? Is this correct? Why is it not recoverable? Do we have a VAT/GST obligation? What could we do differently?</td>
</tr>
<tr>
<td>Balance sheet</td>
<td>Are all the VAT/GST receivables on our balance sheet viable? When are we likely to get repaid? What are our receivables costing us?</td>
</tr>
</tbody>
</table>

Footnote: 1 Restaurants, hotels, car hire, and audiovisual and room hire.
Why act now?

Managing indirect tax refunds, credits and rebates may not be a cutting-edge topic. After all, many of the methods for driving indirect taxes out of the P&L and improving working capital are not new. But business is undergoing constant change. The approaches and decisions of the past (even a few years ago) may no longer be appropriate based on recent developments in tax, business and technology. Taking a fresh look at how you deal with the fundamentals can bring surprising rewards. Some key factors:

**The economic landscape.** In recent years, many companies have faced increasing pressure to improve financial performance and manage working capital more effectively. This trend started with the economic downturn and has intensified in some sectors as a result of digital disruption. By reducing VAT/GST and duty costs and pursuing credits and refunds more persistently and cost-effectively, the indirect tax function can play a valuable part for the whole organization.

**More indirect taxes to manage.** A global business may have more indirect taxes to manage and more opportunities to mitigate them. Globalization of the supply chain may lead to more cross-border movements of goods and additional duty costs. Or the employees of a multinational corporation may travel to more countries and incur more foreign VAT/GST on hotels and restaurants than in the past. As these indirect costs increase, so do the benefits of acting to avoid or rebate them. That may change the decision about whether an action is worth pursuing.

**The changing indirect tax landscape.** Legislative change and changes in world trading relationships are also contributing to the need for global companies to manage indirect tax costs more effectively and to seize opportunities. For example, the introduction of VAT/GST in India and the Gulf Cooperation Council may significantly increase the taxes that flow through the accounts of companies that operate in these regions. With global trade, a new free trade agreement or a new customs code can significantly affect the duty costs for businesses that trade between affected countries.

**The changing direct tax landscape.** Actions related to the wider tax agenda can also influence indirect taxes. In recent years, tax administrations have focused on preventing base erosion and profit shifting, resulting in a greater emphasis on permanent establishment status and intercompany supplies. As a result, customs values may face greater scrutiny as governments collect more transfer pricing information. The focus on local presence may require foreign traders to register for VAT/GST locally more often, perhaps boosting input tax recovery in some countries while jeopardizing past claims in others.

**Greater visibility and scrutiny in the digital age.** As customs and tax administrations demand real-time data, taxpayers may need to refine their reporting processes. This requirement can be onerous, but it can also bring benefits. It may provide greater visibility into the indirect taxes incurred and where they sit in the organization, allowing the company to devise new strategies to drive out costs.
Building the team

Assigning roles and responsibilities and establishing performance targets and benchmarks are crucial to developing and implementing an indirect taxes refund strategy. As indirect tax director, trade director or leader of the tax function, you may take the lead. However, you will need buy-in and contributions from people and systems across your organization, not only to identify likely crunch points and opportunities but also to remain aware of future plans that may affect your strategy. Key functions are likely to include:

- Tax and legal
- Finance
- IT
- Procurement
- Logistics

You may also need to look outside your country and organization for information, services, technology and know-how.
Helping a global bank recover VAT/GST on employee travel

We proposed helping a global bank develop a scalable, efficient and cost-effective process for recovering VAT/GST related to employee travel and expense (T&E) claims. With the new approach, the bank not only increased its claims for foreign and domestic VAT/GST but also identified opportunities to recover other taxes.

Project considerations
Before deciding on the best way forward, we proposed that the bank consider a range of issues, including:

- Should we also review past claims to identify any areas of underclaimed input VAT/GST?
- What are our current processes and technology?
- Can the deductible/nondeductible determinations we use for corporate income tax and employment tax be applied to VAT/GST?
- Can we get better visibility from our VAT/GST reporting?
- What technological enhancements are we considering rolling out within five years? Can improvements to the current VAT/GST reclaims process be “baked into” these enhancements?
- Can any improvements we identify for Europe be expanded to other regions?
- Should we do this in-house or should we outsource?
- If we outsource, can the process be easily brought back in-house in the future?
- What are our peers doing?
Our VAT/GST refunds review
We proposed reviewing the bank’s T&E and accounts payable (AP) processes, its sources of information and its controls for claiming input VAT/GST refunds, as well as the enterprise resource planning (ERP) systems, technology and automation it was already using.

Using data analytics, we helped the bank identify input tax errors and underclaimed VAT/GST for past periods. We also compared the company’s performance against leading practices to highlight opportunities for improvement. The aim of the project was to help management explore a range of in-house and outsourced approaches that would meet the bank’s budget and strategic objectives.

The EY project approach

Review of current T&E expense claim process within AP/P2P process (e.g., 8th and 13th Directive reclaims*)

- Conduct review: Outline areas of concern and industry benchmarks
- Identify industry benchmarks
- Validate areas of concern
- Use data analytics
- Identify areas of concern

Final state – formulate options
- Process improvement
- Options

Future state
- In-house
- Storage, monitoring
- Outsource

*Pursuant to European Commission vs. United Kingdom (C-582/08), non-EU-established financial services and insurance businesses may not be entitled to refunds.
Continuous improvement and ongoing reviews

1. Connect data sources
   - Non-transaction
   - SAP
   - Legacy
   - Oracle
   - PeopleSoft

2. Improve, automate and monitor
   - Master and transaction data
   - Configurable controls
   - Segregation of duties

3. Receive/validate exceptions
   - Notifications
   - Workflow
   - Rationalize exceptions

4. Report and refine
   - Open
   - Closed
   - Pending
   - Requires action
   - Integrated dashboard
   - Further trending and data analytics

5. Refine rules and tailor business processes
   - Process improvement
   - Configuration management
   - User provisioning

CFO – chief financial officer
BU – business unit
IA – internal audit
IT – information technology
Past remediation and future improvement

As a result of our review, the bank identified “missed” and “trapped” VAT/GST for past periods and submitted refund claims where appropriate.

By leveraging plans for future investments in technology and automation, we helped the company’s tax and finance departments work with the business units to implement cost-effective process improvements. The benefits included reduced processing times and increased claims accuracy – leading to opportunities for higher VAT/GST recovery rates in the future while reducing the risk of tax authority audits.

Continuous monitoring and review

After our initial review, we helped the bank adopt in-house VAT/GST data analytics software, allowing it to regularly test its refund processes using its ERP systems. We also introduced enhancements that allowed for continuous improvement and accurate review for every reporting cycle. For example, we developed a bespoke key word repository for expense claims that allows the system’s “robots” to identify allowable, disallowable and doubtful items, while adapting to changes in the regulatory environment and learning from experience.
Managing refunds around the world: country spotlights
Brazil has arguably the most complex indirect tax system in the world. The country has five types of value-added tax (VAT) that can apply to company operations, all based in legislation that is hard to interpret and constantly changing.

Because of all the specificities in Brazilian tax law, VAT rates can vary depending on a number of factors, including:

- The nature or type of product
- The local content of products
- The location of suppliers and customers

All of these, taken together, can result in input VAT credits higher than output VAT debits. As a result, many companies that operate in Brazil must deal with VAT credit accumulation.

How are VAT accumulated credits generated?

VAT credit accumulation occurs when the tax rates applicable to output prices are lower than input VAT debit amounts. Lower output VAT rates can stem from incentives granted for specific products or from the type of transaction (e.g., interstate transactions and exports).

Companies usually face VAT credit accumulation in:

- Export-oriented businesses (exports are tax-exempt in Brazil)
- Interstate output operations
- Incentivized operations (e.g., products subject to VAT exemption)
How VAT accumulated credits are generated

In this example, a retailer buys goods for resale from a supplier located within the same state. This operation is subject to a high VAT rate that generates credits for the buyer.

On output 1, when the company exports, no VAT is levied on the operation, which will cause the accumulation of the VAT credit as an input.

On output 2, the VAT rate for interstate operation is much lower, which will also generate a credit accumulation.

A complex refund process

In every part of Europe, when companies face VAT credit accumulation, they use a refund procedure to reclaim the overpaid VAT. In Brazil, the refund process differs significantly: it does not apply to every credit generated, and, when it does, companies often must expend considerable time and effort to obtain a refund.

Federal taxes. With federal VAT, such as PIS and Cofins and IPI, the law allows accumulated credits to be compensated with other types of federal taxes. Refunds are permitted in some circumstances, but legislation places big demands on companies, and they sometimes go to court to accelerate the refund process.

If a company wants to pursue federal VAT compensation or a refund, it should fill out the “PER/DOMP” form for credit validation purposes.
State VAT. With state VAT (ICMS), no actual refund request is available to companies. Rather, states have designed specific rules so companies can “use” VAT credits in ways other than offsetting output debits. Some allow the transfer of credit amounts to another taxpayer interested in offsetting its output debits; others allow companies to use VAT credits to pay suppliers for goods (with certain restrictions). In each case, the particular state will define the transfer process. Generally, states that allow transfers do so only after thoroughly analyzing and validating the amounts, which can take years.

An even greater challenge with ICMS is that each state places a particular ancillary obligation on taxpayers seeking approval of the credit transfer. In some states, such as São Paulo, governments request electronic returns with detailed information on input and output transactional data, inventory movement, etc.

Because of all these concerns, VAT credit accumulation is a complex issue that can constrain cash flow if companies do not properly manage it.

What should taxpayers do?
Since the compensation and refund process is difficult, companies commonly try to avoid credit accumulation by promoting studies to map the source of credits and designing alternative operations to allow the regular use of credits. Possibilities include holding special VAT regime negotiations with the government to avoid credit accumulations or speed up refunds, and using certain customs and VAT special regimes that grant tax suspensions for local operations.

Taxes in Brazil, especially the state VAT, can change dramatically because of supply chain and sourcing factors. Tax and supply chain operators must work together to determine the best supply and distribution model for the company, including the most VAT-efficient location for manufacturing sites or distribution centers. In Brazil, an efficient logistics chain can result in a financial loss should VAT credits accumulate. That makes it critical to manage indirect taxes from a supply chain perspective.

In a recent EY survey with tax professionals, 55% of them answered that their companies are in a VAT credit position in Brazil.

EY study
EY is creating a group of studies with 15 companies in Brazil that have a relevant tax credit position (such as VAT credit balance and Deferred Income Tax). In the initial estimates, these companies hold more than US$5 billion in tax credits.
Using VAT accumulated credits

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<th>Possibilities for using VAT accumulated credits</th>
<th>Specific ancillary obligation</th>
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| Federal taxes  | ▶ Under some circumstances, it is possible to offset the credit balance with other federal taxes.  
▶ The refund process is possible but difficult. | PER/DCOMP.                  |
| State VAT      | ▶ Each state sets the rules for recovering accumulated credits.  
▶ Usually, credits can be used, with restrictions, to pay suppliers (fixed assets and inputs).  
▶ Some states authorize selling credits (under a special regime). | Varies according to the state. Some states (such as São Paulo and Paraná) request electronic returns that must be submitted in the refund process (e-CredAc and Siscred). |

Footnotes:
1 PIS and Cofins are federally administered social contributions levied on a company’s gross revenue. Under the noncumulative regime, taxpayers calculate PIS and Cofins debits at a 9.25% rate, and credit deductions are allowed, with restrictions.
2 IPI is a federal VAT levied on manufactured products. The rates vary based on the product’s tariff classification code and are guided by the essentiality principle (the more essential the product is, the lower the rate). For credit deductions, IPI credits are basically limited to products used as inputs in manufacturing processes.
3 Electronic Plea for Restitution, Refund or Reimbursement and Declaration of Compensation.
4 ICMS is a state-managed value-added tax levied on the movement of goods and some types of freight and communication services. Brazil has 27 states and 27 different rules for ICMS. The rates vary based on the state where the operation takes place and the types of products and services provided, among other factors, but they usually range from 4% on interstate operations to 17%, 18% or 19% on operations within the same state. With credit deductions, ICMS credits are limited to products and services related to the company’s core business.
Introduction of VAT refunds in China

Refund policies for VAT

China\(^1\) has three categories of VAT refunds.

Export tax refund (exemption)

This policy covers exported goods, foreign-oriented processing, repair and replacement services\(^2\) and certain cross-border taxable services. Refunding VAT and consumption tax paid on goods and services during domestic production and circulation allows domestic products to enter the international trade market with a tax-free price. That makes domestic products more competitive and helps satisfy World Trade Organization trade rules and conventions for balancing the global tax liability.

“Refund upon imposition”

The “refund upon imposition” tax policy covers certain domestic sales of goods or taxable services. This benefit is generally targeted at industries that are supported or encouraged by the government, including but not limited to:

- Enterprises that employ people with disabilities
- Software
- Cartoon animation
- Integrated-use resources

Several types of refund upon imposition exist. The refund may be granted, wholly or partly, when the tax payment is made or after it has been made.

All types of refund upon imposition are viewed as a preferential tax treatment.

The amount of refund granted depends on the industry involved. For example, for general VAT payers selling self-developed software products, VAT is due at the rate of 17%. If the actual VAT burden exceeds 3%, the portion in excess of 3% should be refunded; for repair and maintenance of aircraft, if the VAT burden exceeds 6%, the portion in excess of 6% should be refunded on payment; for hydroelectric power stations with installed capacity of 100 MW that sell self-produced electric power, if the actual VAT burden exceeds 8%, the portion in excess of 8% should be refunded.
Tourist tax refund on goods purchased upon departure from China
This policy covers goods purchased by foreign tourists. VAT on items purchased from shops that operate the VAT retail export refund scheme can be refunded when foreign tourists depart from international ports. The term “foreign tourists” for these purposes includes foreigners and individuals from Hong Kong, Macao and Taiwan who live in mainland China for less than 183 consecutive days.

Issues for consideration
Most excess VAT carryover cannot be refunded
Excess VAT carryover results when the input VAT of the current period is higher than output VAT. The excess amount can be carried forward to offset output VAT in the next period. In China, taxpayers can carry forward excess VAT without limits on the period. A recent pilot program also allowed excess VAT from certain activities to be refunded, including:

- Purchasing equipment by enterprises that have state-approved major integrated circuit projects
- Performing research and manufacturing activities on large aircraft or their engines
- Manufacturing and selling new regional aircraft

Most taxpayers do not conduct activities covered by this pilot program, so their cash flow suffers since excess VAT carryover cannot be refunded. Affected taxpayers may consider how to use the excess carryover, including rolling it into costs, transferring it to a new entity and using it on reconstruction, and conducting export and import business to offset output VAT or to get the refund directly. However, when taxpayers stop operating and de-register the business entity, excess VAT carryover is generally unrecoverable and could be lost unless the entity plans proactively to use the excess before ceasing to trade.

Refunds may be restricted by tax policy
As China’s VAT system “develops” the tax authorities have a number of tax policy issues to address connected with allowing VAT credits and refunds. Allowing VAT refunds in all industries could pose difficulties such as:

- Revenue and the revenue-expenditure balance could be negatively affected.
- Since VAT revenue and refunds are distributed between the central and local governments, the revenue of local governments could suffer and be unjustifiably distributed.
- The tax crediting system is still developing, so the risk of refund fraud is relatively high.
China

The VAT rate for certain exported goods is higher than the VAT refund rate
Exported goods benefit from a zero-rating treatment – that is, the VAT rate of certain exported goods should equal the VAT refund rate. However, according to the Export Tax Refund Rates Library, nearly two-thirds of goods have a VAT rate higher than the rate of refund. Under the relevant regulations, the difference should be accounted for as a service cost, resulting in an additional burden for export enterprises.

Export tax refund claims can impinge on exporters’ cash flow
The declaration procedures for export tax refunds are complicated, the examinations are rigorous and the processing speed is slow. All of these factors may increase the burden for exporters. For example, because of the high incidence of export tax refund fraud, the authorities have established strict examining regulations for these refunds, and they have strengthened their implementation. Once the authorities raised doubts about a potential refund or launch a fraud audit, they can delay a taxpayer’s refund application until the matter is resolved. The audit and verification process can be time-consuming, which can have a negative effect on the taxpayer’s cash flow.

The operation of the tourist tax refund needs refining
The pilot program for the tourist tax refund on goods purchased upon departure from China currently has no unified nationwide information system, so that information cannot be exchanged in real time across all locations. As a result, if a foreign tourist shops in a location within the pilot program but departs from a location outside the pilot program, the tax cannot be refunded.

The tax burden can sometimes be adapted to receive “refund upon imposition”
The “refund upon imposition” of VAT is calculated monthly, without any unified settlement provisions. Under certain circumstances, taxpayers can plan and adapt the timing of their income recognition and input tax deduction to achieve a higher or lower “refund upon imposition.” For example, if they incur less input VAT during a certain period and generate more taxable income and thus report more tax payable in a certain month, to achieve a higher tax payable than the threshold of “refund upon imposition.” Thus taxpayers could receive a “refund upon imposition” in the current month. Later they incur more input VAT (including the portion delayed for recognition) and generate and account for less taxable income (even zero income) to achieve an overall lower tax payable.

The introduction of new management systems for VAT refunds
The new VAT fapiao management system
Because VAT is controlled through fapiao (invoices), VAT special fapiao are important evidence for enterprises seeking to deduct input VAT and declare export tax refunds. To strengthen the management of special VAT fapiao, China implemented an anti-counterfeiting system in July 2003. In 2015, that system was upgraded to the new VAT fapiao management system.
The new fapiao management system has the following features:

- It collects data including taxpayer name, product name, price per unit, quantity, tax payable and tax rate, and builds a fapiao database.
- It upgraded the fapiao information transformation. In the past, taxpayers issued fapiao by computer and declared to tax authorities periodically. With the new system, taxpayers can issue fapiao documents and upload information to tax authorities in real time. Taxpayers' declaration data and fapiao issuance data are reconciled in real time. This system makes it easier for taxpayers to check, certify and deduct input VAT in a timely manner, and it helps tax authorities with comprehensive and timely management.
- It uses digital signature technology to limit data tampering and theft by protecting taxpayers' online data. Having a unified verification platform dramatically reduces VAT fapiao fraud.

The export tax refund management system

The export tax refund management system is composed mainly of the Declaration of Tax Refund information system, used by enterprises, and the Examination of Tax Refund information system, used by the tax authorities.

- **The Declaration of Tax Refund information system**
  Enterprises must enter relevant export and procurement data to generate a declaration form for export tax refunds and electronic declaration data. Certain regions of China have implemented a paperless declaration pilot program, in which enterprises need only to provide electronic declaration data to tax authorities.

- **The Examination of Tax Refund information system**
  Tax authorities use this system to examine tax refund declarations. They also reconcile electronic declaration data on import and export goods provided by the Customs and Excise Department, export data collection provided by the State Administration of Foreign Exchange, VAT special fapiao data provided by the new fapiao system and enterprises' application data. If a declaration meets the refund requirements, it will be processed in the system.

Footnotes:
1. China refers to the mainland China tax jurisdiction.
2. Also including export goods or provide processing, repair and replacement services to Hong Kong, Macao, Taiwan, and customs special supervision areas, which should be viewed as export and enjoy export tax refund (exemption) policy.
3. The Export Tax Refund Rates Library published by the State Administration of Taxation.
France

VAT refunds in France

The most significant indirect tax refunds in France apply to VAT. Because it's an EU Member State, many of the laws and regulations that apply to indirect tax in France are governed by EU law. However, like all Member States, France has its own rules and administrative practices that affect foreign and domestic tax refunds, such as the detailed rules on input tax deductions, rules for tax audits and the need for taxpayers to maintain a detailed tax audit file.

Understanding and complying with the detailed local rules for submitting applications and preparing for audits are crucial to making successful claims. At the same time, identifying possible pitfalls and opportunities to improve indirect tax performance can reduce absolute costs and improve cash flow.

VAT refunds

Domestic VAT refunds: Businesses registered for VAT in France may request a refund for excess input tax by submitting a specific VAT refund claim. The refund cannot be applied for directly on the monthly VAT return. Refund claims can be made monthly (or yearly), and refunds are generally issued in one to three months.

Businesses that are in a regular refund position may consider ways to improve cash flow (e.g., by making VAT-free purchases related to exports).

Foreign VAT refunds requested by companies established in other Member States: Eligible taxable persons established in other Member States may request refunds of French VAT through the procedures defined in EU Directive 2008/9/EC. The deadline is 30 September of the year following the calendar year when the tax was incurred. The minimum claim period is three months, and the maximum claim period is one year. Since 2010, EU refund claims have been handled through an electronic portal.

If the company seeking an input tax refund under this provision belongs to a foreign VAT group, only the foreign parent company is entitled to claim the refund of the VAT credit in France.

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Foreign VAT refunds requested by non-EU companies: non-EU businesses are entitled to refunds of VAT paid in France under the conditions of the EU 13th Directive. France does not exclude any non-EU countries from the refund process. The minimum claim period is three months, and the maximum claim period is one year. The claimant must make direct applications for refund and must appoint a VAT representative. Applications must be completed in French. The deadline is 30 June of the year following the calendar year when the tax was incurred. Refunds claimed under the 13th Directive procedure must be submitted on paper.

Monitoring foreign VAT refunds: any foreign company that claims a direct VAT refund should also set up a process to monitor the refund until it has been received. Any delays may result in late-payment interest from the French tax administration, provided that the claim was completed correctly and complied with all conditions.

Improving cash flow

Businesses that operate in France may consider a number of measures to improve VAT cash flow.

Domestic VAT registration for foreign companies: in addition, if the French VAT refunds are significant or are likely to exist for a while, a foreign company may want to consider changing the structure of the transaction and altering how it conducts business in France (e.g., in the physical flow of the goods) to become VAT-registered in France. Domestic VAT registration would, for example, allow the company to recover input VAT monthly. Although the company’s first VAT refund claim is likely to be delayed to satisfy additional inquiries from the French tax authorities, subsequent VAT refund claims could be granted without additional questions.

VAT grouping: France has implemented a provision that allows closely related companies to form a VAT group, but only for consolidating their VAT balances. Grouped companies can offset VAT refunds due to one member against VAT amounts due from other members and pay the net output due. Thus, forming a VAT group may allow related companies to improve cash flow and cash management by reducing VAT credits and payments for the corporate group as a whole.

Unlike in some EU Member States, VAT groups with members that make exempt supplies and members that make taxable supplies are not permitted to consolidate their turnover for calculating input tax recovery.

VAT-free purchases by exporters: France has implemented Article 64 of the EU VAT Directive\(^1\) to enable exporters to purchase VAT-free goods (and certain services) that are imported or purchased in France, provided that the goods or services are designated for further exportation or delivery to another Member State. By treating the supply made to the exporter as VAT-free, this rule can greatly improve cash flow for exporting companies by reducing excess input VAT.
France

Reverse charge for imports: since 2016, France has permitted VAT-registered importers to apply the reverse charge for the VAT payable at importation. This effectively improves cash flow and reduces VAT credit balances for most importers, as the VAT due is payable and refunded at the same time.

Effective 1 January 2017, companies must obtain pre-authorization to use the VAT reverse charge mechanism for imports.

Import VAT refunds for customs value reductions: it is possible to claim a refund of the VAT paid on importation if the customs value of imported goods has been reduced (e.g., as a result of a transfer pricing adjustment or a price reduction provided in the agreement) or if the wrong customs treatment was applied to the goods. In such cases, the single administrative document (SAD) used for the import must be invalidated or corrected before the importer can request a VAT refund from the customs administration.

VAT audits

In practice, claiming a VAT refund in France may result in a tax audit, especially if a VAT refund is claimed for the first time or if the amount claimed is relatively high (e.g., more than €500,000). For a first VAT refund claim, the French tax administration usually asks for a list of the purchase invoices related to the claim and the date of payment of each invoice.

Since 1 January 2017, the French tax authorities have reinforced their capability to perform an on-site audit, i.e., they may send French tax controllers to the company’s premises to audit its accounting records and documents (previously only tax inspectors were permitted to perform on-site audits). The permitted hours for performing on-site tax audits are between 8 a.m. and 8 p.m. The new rules aim to increase the number of VAT audits since a tax controller (rather than a tax inspector) can perform the audit; and to accelerate the VAT refund time as the tax inspector has 60 days from its first visit to make a decision.

At the beginning of the on-site VAT audit, the taxpayer is obliged to provide its detailed accounting books in a pre-defined electronic format (“Accounting Entry File” or “fichier des écritures comptables – FEC”).

From 1 January 2017, a remote VAT audit may also be carried out, based on testing of the Accounting Entry File.

These procedures apply equally to all companies registered for VAT purposes in France, including foreign companies (whether or not they are established for VAT purposes in France).

Preparing for successful tax audits

One of the best ways to help bring about a successful VAT refund claim is to be prepared for a VAT audit.

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Preparing for successful tax audits

One of the best ways to help bring about a successful VAT refund claim is to be prepared for a VAT audit.
Key actions include:

- Performing reconciliations (e.g., between the turnover reported on the company’s corporate income tax return and the VAT returns; between the balance sheet and the VAT returns; and between the VAT returns and the Intrastat returns)
- Understanding reasons for any inconsistencies and taking action to correct errors where necessary
- Creating easy access to original purchase invoices for the past three years
- Verifying that all VAT returns have been duly submitted and paid
- Gathering all supporting documentation for exports and intra-Community supplies of goods exemptions
- Checking invoices to confirm that all exemptions are correctly cited in accordance with French VAT law
- Implementing effective internal controls to prevent VAT fraud
- Preparing a compliant accounting entry file to give to auditors on the first day and to anticipate any questions they may raise
- Providing a reliable audit trail of documentation (for paper and non-secured electronic invoices) required by the French tax administration

Footnotes:
2. France has implemented Article 233 of the EU VAT Directive in a strict way, requiring business controls showing the existence of the reliable audit trail to not only exist but also be documented and archived.
Despite belonging to the European Union and having to comply with EU regulations and directives, Italy bases its VAT rules on Presidential Decree No. 633/1972 (the VAT law). The law establishes requirements and administrative procedures related to claiming VAT refunds.

This report aims to provide broad insight into Italy’s VAT refund framework, as well as methods to manage cash flow.

VAT refunds

Domestic VAT refunds: the law makes it possible to recover VAT credits accrued in Italy for companies established or VAT-registered in Italy (through the VAT identification process for EU-established entities and through the appointment of a VAT representative in Italy for non-EU-established entities).

How to claim

Refunds can be claimed through the yearly VAT return, to be filed by the end of February 2017 for fiscal year 2016 or, under the new VAT rules, by the end of April of the following year for fiscal year 2017 and beyond. The VAT law also makes it possible to claim VAT credits quarterly during the fiscal year, but only in the first three quarters. VAT credits accrued in the fourth quarter can be claimed through the yearly refund procedure. Quarterly VAT refunds are claimed through “TR forms” within the month following the quarter of reference.
Who can claim?
The VAT law specifies the following cases for claiming refunds:

- The VAT rate on purchases is higher than the relevant average VAT rate on sales.
- The VAT taxpayer carries out zero-rated transactions (e.g., exports, intra-Community supply of goods) for an amount above 25% of annual turnover.
- The VAT credit is related to the acquisition of depreciable goods or goods and services for research and development (for quarterly VAT refund claims, the amount of the mentioned purchases must account for two-thirds of the acquisitions performed during the quarter of reference).
- The VAT taxpayer carries out transactions mainly outside the scope of Italian VAT (for quarterly VAT refund claims, the amount of the mentioned transactions must exceed 50% of annual turnover).
- The claimant is a nonresident business that is VAT-registered in Italy.
- If none of the specific conditions are met, the annual VAT refund can be claimed only when the annual return shows a credit for three continuous years. In the third year, the amount that can be claimed is the lowest of the three VAT credit amounts.
- A VAT refund can be requested when business activity is ended.

What is the timing?
Even though the VAT law calls for payments to occur within three months of the deadline for the claim, the effective payback timing is much longer. The average payback period is influenced by the chosen refund procedure. The credit sought with the yearly VAT return can be claimed through two procedures:

- **Fast procedure**: the company can claim a VAT refund for up to €700,000.
- **Ordinary procedure**: the company can claim the portion of VAT credit exceeding €700,000 (for which it has benefited from the fast procedure).

Typically, VAT recovery can occur:

- For quarterly refund claims — 8 to 10 months from the date of the claim
- For the yearly fast refund procedure — about 8 months from the date of the claim
- For the yearly ordinary procedure — 18 to 24 months from the date of the claim

What is the procedure?
Once the VAT credit has been claimed, the taxpayer should file an insurance policy or bank guarantee upon request by Italian tax authorities for any claim exceeding €30,000. The grant can be assumed by the controlling company of groups with a consolidated net equity exceeding €250 million. The VAT law waives the insurance policy or bank guarantee for taxable entities that meet the following conditions:

- The annual VAT return or quarterly VAT refund form must report a certification of a tax professional verifying the VAT credit (visto di conformità) or bear the signature of the audit company.
- The taxpayer must issue a self-declaration that it has solid capital, is an active business and regularly makes social security contributions.

The guarantee or insurance policy will remain mandatory for:

- Inactive or ceased business
- Businesses that have traded for less than two years
- Taxpayers that received assessments in the previous two years for taxes other than VAT where the assessed tax exceeds certain thresholds
Italy

**Italian VAT refunds requested by companies established in other EU Member States.** Taxable persons established in other EU Member States and not registered for VAT in Italy may ask for refunds of VAT credits accrued in Italy through procedures established by EU Directive 2008/9/EC. The deadline is 30 September of the year following the calendar year when the tax was incurred. The minimum claim period is three months, and the maximum claim period is one year. The minimum claim amount is €400.

**Italian VAT refunds requested by non-EU companies.** Non-EU businesses that are not registered for VAT in Italy may request refunds of VAT paid in Italy under the conditions of the EU 13th Directive. However, entities can access this procedure only if their countries have reciprocity agreements with Italy (such as Israel, Switzerland and Norway). Businesses established in countries without such agreements cannot obtain VAT refunds.

**Improving cash flow**

For business or legal reasons, taxpayers may constantly accrue VAT credits. This can constrain cash flow, especially considering that tax authorities often take a while to pay back claimed credits. The VAT law offers ways to optimize cash flow.

**“Net exporter”**

Under the VAT law, businesses can acquire “net exporter” status if they meet certain conditions. VAT taxpayers may be deemed net exporters if, during the previous calendar year or the previous 12 months, they carried out zero-rated exports and intra-Community supplies for an amount more than 10% of their turnover.

With this status, taxpayers can purchase and import goods and services without facing any VAT charges on the invoices. The VAT-free purchases are limited to a specific threshold (plafond) paired with the amount of zero-rated supplies (i.e., exports of goods, zero-rated services and intra-Community supplies) invoiced and booked in the VAT sales ledger in the previous calendar year (fixed plafond) or in the previous 12 months (movable plafond). Taxpayers can choose between the two methods.

**VAT warehouse**

A VAT warehouse is a physical place where goods can benefit from a VAT suspension regime because the transactions are made while the goods are introduced and stored therein. This option might be particularly useful for chain transactions, which cannot benefit from the simplification rules of triangulations.

The goods must be physically introduced in the VAT warehouse, and there must be a real economic justification for doing so. An in-depth analysis is always advisable before applying for a VAT warehouse.

**Consignment stock or call-off**

The consignment stock is a supply contract providing for goods to be dispatched to the purchaser without a transfer of ownership. The purchaser has the goods at its disposal because they are located in its store or in a third-party’s store.

Since the supplier retains ownership, no transaction is performed. In fact, ownership will be transferred when the recipient or purchaser decides to withdraw the goods from the store. That withdrawal will trigger invoicing obligations and the entering of the invoice on the supplier’s VAT ledger. The purchaser will become the owner and make the payment. The VAT law implemented the EU simplification to allow foreign suppliers to register for Italian VAT purposes for transferring their own goods to an Italian consignee.
VAT grouping
The VAT group allows participating companies to offset VAT credits and debits of group members – a useful instrument for improving cash flow. Under the VAT law, each business keeps its judicial autonomy as a singular taxpayer.

The Budget Law 2017 has introduced new rules for VAT grouping, applicable starting 1 January 2018.

Through a VAT group, the entities will be treated as a single VAT taxable person.

In brief, taxable persons carrying out business or professional activities – with financial, economic and organizational links – can be treated as a single taxable person, identified with one VAT number.

VAT checks by the tax authorities
The filing of a VAT return or TR form claiming a refund prompts the tax authorities to release a request for documentation (similar to an official tax audit) so they can perform checks to verify the VAT credit. Generally, the documents requested are:

- VAT ledgers
- Copies of purchase and sale invoices (it is usually possible to agree with tax authorities to submit a sample invoice)
- Proof of payment for purchase invoices
- Main supply contracts
- A short note clarifying the business activities and the reasons for VAT credit accrual
- A statutory declaration of conformity of the copies provided with the original documents

Authorities may request further documents linked to the specific reason a company is entitled to claim a VAT refund.

Before seeking a VAT credit refund, taxpayers should perform an analysis and pre-check of the documentation that authorities will request. By taking this essential step, taxpayers will be prepared when authorities request documentation, and they can certify the VAT credit, avoiding the filing of the bank guarantee if they meet the required conditions.
Malaysia introduced a goods and services tax (GST) on 1 April 2015. The tax applies to all goods and services supplied in Malaysia and to imports unless a specific exemption is in place. A taxable person can recover GST incurred on expenditures used to make taxable supplies (as input tax) but not exempt supplies.

Taxpayers may encounter several issues with GST credits and refunds.

Delays in approving refund claims

A taxable person generally recovers input tax on domestic purchases and imports by deducting it from the tax due on sales (output tax) and remitting the difference. If the input tax in a period exceeds the output tax due, the excess is refundable. The taxpayer may either claim a refund or carry forward the excess to the next taxable period. In either case, the taxpayer needs prior approval from the Royal Malaysian Customs Department (RMCD). According to RMCD guidance, any refund should be made within 14 working days after the return period if the return is submitted online and 28 working days if the return is submitted manually.

These time limits provide for quick refunds, but the primary issue for most taxpayers is long delays by the RMCD in approving the refund or carryforward. Generally, the delay is due to a request for further information to verify that:

- The input tax claimed relates exclusively to eligible items.
- Valid supporting documents are available.
- For a mixed supplier (who makes GST-taxable and GST-exempt supplies), the input tax is claimed in accordance with the prescribed formula for partial exemption.

Prior approval for claiming input tax credits

If a taxable person does not claim input tax in the taxable period for which it holds a valid tax invoice, it can still claim the amount within six years. However, the taxpayer needs prior approval from the RMCD – a requirement that increases both the administrative burden and GST compliance costs. A taxpayer is considered to hold a tax invoice on the earlier of:

- The date or time when it posted the invoice in the company’s accounts payable system
- One year from the date it receives the invoice
Pre-registration expenses

A company can obtain registration only when the value of its supplies is expected to exceed the prescribed GST threshold (annual taxable turnover of MYR500,000). Although the law permits voluntary registration for the period before business commences, it is approved only when the taxpayer can substantiate that the first taxable supply will be made within 12 months from the application date. The strict adherence to the 12-month rule does not allow GST registration for the start-up period for many companies, blocking input tax credits on goods and services acquired prior to registration.

Once registered, the taxpayer, with prior approval from the RMCD, can claim input tax credit on acquisitions made in the pre-registration period, with the exceptions of the following goods:

- Goods that had been supplied or consumed
- Goods that have been used partially or incorporated into some other goods
- Goods held for other than business use

Based on the guidelines provided by RMCD as per the GST guide on Input tax credit, updated as of 4 January 2017, input tax on goods held on hand can be taken in respect of goods acquired within six years before the date of registration. It is pertinent to note that recovery is permitted only on goods, not services. Therefore, GST on pre-registration acquisitions of service becomes a cost.

GST recovery by foreign companies

If a foreign entity with no fixed establishment in Malaysia makes a taxable supply of goods in the country, it must register for GST by appointing an agent in Malaysia. The agent must comply with GST obligations on behalf of the foreign entity and can claim input tax credit. The requirement for GST registration triggers only when the value of taxable supplies exceeds the registration threshold of RM500,000.

This provision applies only to a foreign entity that supplies goods, not services. In the latter case, the customer is subject to a reverse charge on business-to-business transactions, and the supplier cannot register for GST. Any input GST incurred by a foreign supplier of services becomes a cost.

Automotive sector: blocked input tax for imported cars

Importing a car into Malaysia requires an approved permit (AP). If the buyer lacks an AP, the buyer must instruct a third-party to import the car on the buyer’s behalf. However, the buyer cannot reclaim the input tax incurred on importing the car because the customs clearance form is not in the buyer’s name. Input tax incurred becomes a cost.

Financial services: fixed input tax recovery rates are changing

With the introduction of GST, licensed banking institutions were given a fixed input tax recovery rate (FITR) for recovering input tax incurred on goods and services acquired in the normal course of business. In 2015 and 2016, two different rates applied, depending on the type of license held. Commercial banking license-holders were entitled to recover 70% of input tax while investment bank license-holders could recover 78%.

In January 2017, the Ministry of Finance informed affected institutions that it will no longer distinguish banking institutions by license type when determining the FITR. Effective 1 January 2017, every institution is required to apply an FITR specifically assigned to its institution. This change could harm GST recovery rates for institutions whose FITR was higher before the change.
Indirect tax credits are any amounts in favor of a taxable person or trader derived from transactions within Mexican territory. Indirect taxes such as VAT, excise tax and duties arise from the importation, manufacture, distribution and sale of goods, as well as the rendering of services.

Credits for these taxes are mainly caused by:

- The supply of goods and services in Mexico by a taxable person
- The supply of goods and services subject to the reverse charge
- The granting of temporary use or exploitation of goods
- The importation of goods

Poor management of indirect tax credits causes additional costs and negative cash flow. If transactions are not properly analyzed, the indirect taxes paid may not be recoverable. Improper management could also lead to excess payments or delayed refunds.

How to obtain a refund

In general, the refund process involves one of three alternatives:

- Offsetting the indirect tax credit position against future liabilities of the same tax
- Offsetting the indirect tax credit position against future liabilities of other federal taxes
- Submitting a refund claim to the Mexican tax authorities

Cross-border VAT – a cost to foreign businesses

Cross-border VAT is triggered when nonresidents conduct transactions in Mexico. A non-established business generally cannot recover VAT paid in Mexico. Commonly, foreign nonresidents are affected by cross-border VAT on the following transactions:

- Acquisition of goods from a Mexican entity
- Rendering of services by a Mexican entity

Because VAT paid by a foreign resident is not recoverable, the tax should be considered a cost on the operation.
Diplomatic missions
An exception applies to activities conducted by diplomatic missions and international agencies represented or based in Mexico. Diplomatic missions are entitled to request a refund for VAT paid in Mexico if they can demonstrate “reciprocity” to the Mexican Government.

Reciprocity: through their embassies, refund applicants must annually file a “confirmation of reciprocity” statement with the General Protocol Management of the Mexican Ministry of Foreign Affairs. The confirmation must contain the limit for the amount, type of goods or activities, percentages or rates, and any other specifications or limitations applicable to certified Mexican diplomatic missions with foreign governments regarding the VAT refund or exemption, or its equivalent.

Refund procedure: diplomatic missions and international agencies should file a monthly VAT refund request with the Mexican tax authorities through their embassies. It must contain the corresponding invoices and, for diplomatic missions, the confirmation of reciprocity.

Eight key actions for claiming a VAT refund

- Confirm that all e-invoices received from suppliers in the corresponding month are correct and that the digital stamps are in force
- Review all e-invoices issued by the entity in the corresponding month
- Analyze the reconciliation of bank statements and wire transfers against the transactions of the main suppliers that triggered the reclaimable input VAT
- Confirm that the Informative Declaration of Operations with Third Parties (DIOT in Spanish) is correct
- Review the monthly VAT declaration
- Compile a file with all information and documentation listed here
- Submit the VAT refund claim with the Mexican tax authorities by filling out the F3241 template and corresponding annexes
- Follow up with tax authorities about the refund by attending meetings with them to explain the assessment of the favorable balance and by providing supporting documents and workpapers
An outline of the VAT refund process in Mexico

Local VAT registration
Legal entities established within Mexican territory must register for VAT and other taxes individually. The tax registry provided by the authorities covers registration for all Mexican taxes, including income tax, VAT and excise tax. VAT-registered entities are permitted to recover VAT on purchases as input tax. Therefore, nonresident businesses that could incur large sums of VAT may consider establishing a legal entity in Mexico to prevent irrecoverable costs.

Domestic VAT credits
In general, only one formal procedure exists for obtaining a VAT refund from the Mexican tax authorities. However, other options may be considered, such as offsetting the credit against other taxes. The main difference between these options is cash flow. With a refund, the entity gets the cash back. With the offset, it uses the credit to pay other taxes.

In deciding whether to apply for a refund or offset a VAT credit, entities should consider:

- Their tax position (e.g., do they have a tax credit awaiting payment until an ongoing audit is complete, or are they up to date on compliance?)
- Their need for cash
- How much time tax authorities will likely take to analyze and process a refund request
- The requirements that must be met to request a refund or offset the credit

Managing indirect tax refunds
The refund procedure
Each month, a Mexican entity must file a declaration stating its VAT balance. If the amount is a favorable balance or credit, the entity can request a refund at any time during a statutory limit of five years.

Pre-registration expenses
All individuals and corporations can recover the VAT triggered on expenses incurred before they begin carrying out taxable activities for VAT purposes, as long as they are already registered with tax authorities. VAT can be recovered through one of two options:

- Begin crediting VAT on start-up costs on the tax return for the first month that the company starts taxable activities for the purposes of the VAT law
- Request the refund of the corresponding VAT in the following month in which expenses and investments were made, based on the estimated % of VAT on purchases that is refundable (“creditable factor”).

When requesting a refund in the pre-operating period, entities should file the following information:

- Details of the expenditures, estimated investments and taxable activities to be carried out, as well as property titles, agreements, authorizations, licenses, permits, plans and any other information necessary to establish that such activities will be conducted
- The estimated creditable factor for the entity’s taxable activities
- The source of financial resources used during the pre-operating period
- The estimated start date for carrying out taxable activities for VAT purposes

Once the entity has carried out regular taxable activities for a year — and the actual proportion of recoverable VAT is known — the creditable VAT for the pre-operating period must be adjusted. A variation of 3% recovery is accepted. If too much VAT has been refunded, the entity must reimburse the excess, with inflation adjustments and surcharges. Similarly, it may request additional tax if it has claimed too little. The reimbursement or increased credit adjustment claim must be made in the month when the adjustment amount is calculated.

Avoiding domestic VAT credits
Reverse charge accounting for imports
According to the VAT law, the importation of intangibles or tangible goods is a taxable activity subject to the general 16% rate. For the importation of intangibles, including services, even though it is a taxable activity, the VAT law allows the application of the reverse charge mechanism, through which payable VAT is declared and credited in the same month the transaction took place.

The purpose of the reverse charge mechanism is to allow the credit of the input VAT due to the importation of intangibles as if they had been acquired locally.
Making successful claims
Why do taxpayers fail to claim refunds?
The main reasons why companies do not claim indirect tax refunds in Mexico are:

- Lack of awareness of their situation and the possibility to file a claim
- Unfamiliarity with the refund procedure and corresponding requirements
- A lack of supporting information or documentation (such as e-invoices, agreements and customs declarations)
- The time that tax authorities may take in reviewing the material
- The desire to avoid requests for additional information or audits

Why do claims fail?
The main reasons why claims fail are:

- Transactions have been carried out with suppliers on the tax authorities’ “noncompliant taxpayers list” (also known as “the blacklist”).
- Information or documentation needed to support the favorable balance of indirect taxes is missing (e.g., e-invoices, bank statements, loan agreements and certificates of origin).
- The input tax is not recoverable (under the VAT law, any expenses considered nondeductible for income tax purposes should be considered non-creditable for VAT purposes).
- The company does not comply with all requirements for crediting indirect taxes (e.g., the VAT has been effectively paid, and it is supported by an electronic invoice).
- Taxpayers fail to follow up on the refund with tax authorities.

Nontaxable purchases for exports: IMMEX

In Mexico, purchases are not treated as nontaxable. The VAT law establishes a list of goods whose sale is exempt from VAT regardless of whether they will remain in Mexico or will be exported.

The VAT law also exempts sales conducted between two foreign entities of goods temporarily imported by a company holding a Manufacturer, Maquiladora and Export Service Industry Program permit (IMMEX in Spanish), with physical delivery to another IMMEX entity.

The two IMMEX entities should follow the virtual operations procedure set forth in the General Foreign Trade Rules, under which an exportation and a temporary importation operation must be filed with customs authorities.
### Some key considerations in claiming an indirect tax refund in Mexico

<table>
<thead>
<tr>
<th>Favorable balance</th>
<th>Is the balance within the five-year statutory limit?</th>
<th>Is the company compliant with all the requirements for the refund?</th>
<th>Do you have all the supporting documentation for the refund?</th>
<th>File the refund request</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td>Yes</td>
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</tbody>
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Do not request the refund

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### Improving the chances of success

Paying attention to key areas can improve the chances of a successful claim.

### The digital tax regime

In Mexico, the use of technology and analytics has become an essential part of the interaction between tax authorities and companies. Electronic invoices, electronic accounting, online filing of tax returns and payments, tax mail, electronic signatures and electronic audits are all tools that tax authorities are using to analyze indirect tax information, almost in real time.

### Real-time data

In Mexico, financial and tax information must be up to date as it is reported to the tax authorities. Automated processes, specific tools and formats, tracking and matching of invoices, validation reports, data security and comprehensive analytics are some of the demands that e-audits are placing on companies’ systems and operations. In this new digital framework, companies must conduct data analytics on their information, including validating their supply chain and clients to anticipate how the government will match, analyze and audit their operations.

### Data analytics

Data analytics software can help companies file refund requests based on information that has proved to be valid, accurate and complete. As a result, follow-up questions from the authorities should be fewer, and additional requests for information should be easier to satisfy, shortening the wait for refunds.
Data analytics can help anticipate how Mexican tax authorities will reconcile, analyze and audit operations. Companies that still rely on traditional manual processes could face irrecoverable indirect tax balances, balances recovered after long periods (hindering cash flow), multiple information requests from authorities, audits, assessments and penalties.

The main benefits of data analytics are:
- Performing a sophisticated analysis to verify tax compliance and identify savings opportunities and risks
- Analyzing foreign exchange rates and measuring the volume of operations in other currencies
- Using predictive models to identify noncompliant suppliers and other erratic behaviors that could raise questions or cause refund denials
- Identifying the need for process improvements
- Improving tax decision-making through business intelligence
- Reducing tax compliance costs while improving accuracy
- Minimizing the probability of an unfavorable audit and corresponding fines

For customs purposes, the relevant information and documentation may vary depending on the customs regime. Companies should generally have these documents to support import and export operations.

Import operations:
- Customs declaration
- Commercial invoices and corresponding electronic value declarations
- Transport documentation
- Insurance policy that covers the transport of goods abroad, if applicable
- Supporting documentation of compliance with non-tariff restrictions (e.g., non-commercialization letters, import permits)
- Certificates of origin, if applicable
- Calculation sheet
- Value manifest

Export operations:
- Customs declaration
- Commercial invoices and corresponding electronic value declarations
- Transport documentation
- Supporting documentation of compliance with non-tariff restrictions (e.g., non-commercialization letters, import permits)

For VAT purposes, the most relevant information and documentation are:
- E-invoices
- E-accounting
- Agreements
- Permits, authorizations, licenses granted by government institutions, etc.
- Loan agreements
- Bank statements
- Workpapers, including the assessment of monthly VAT
- Monthly VAT declaration
- Monthly Informative Declaration of Operations with Third Parties
- A clear explanation of the activities that generated the favorable balance

Systems, processes and documentation
Adopting robust systems and complete processes can facilitate the detection of refunds, as well as the collection of corresponding information and documentation.

Providing complete and accurate documentation is essential to support the claim and to demonstrate the company’s entitlement to the credit.
## Reviewing your strategy for indirect tax refunds in Mexico

<table>
<thead>
<tr>
<th>Key questions</th>
<th>Considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do we have a refund or credit on the balance sheet?</td>
<td>Companies with a favorable indirect tax balance have a high possibility of obtaining a refund.</td>
</tr>
</tbody>
</table>
| Can we claim a refund or credit? | These elements must be considered:  
  - The origin of the credit balance  
  - Whether the balance is also declared in the corresponding tax return or declaration  
  - Is the company compliant with all its tax obligations? Has it timely filed returns, paid all the corresponding taxes and complied with e-accounting obligations?  
  - Does the company have the supporting documentation it needs (e.g., e-invoices, agreements, bank statements, account registries and customs declarations)?  
  - If the company is nonresident, will any VAT be lost? Can the company use IMMEX to avoid VAT charges on the transaction? Can it use a different supply chain structure? |
| Should we claim?  
  - Is it worth it?  
  - What will it cost?  
  - What is the downside? | Asking for a refund is generally not complicated or expensive in Mexico. It involves an electronic proceeding filed through the tax authorities’ website. However, compiling the relevant information can be more complex and time-consuming if the company lacks appropriate processes or controls.  
  - The downside of asking for a refund in Mexico is the timing. The tax authorities have become stricter when reviewing the information for the refund process. Depending on the level of scrutiny, refund claims can take six to eight months. However, if the company is certified for VAT and excise tax purposes, the refund may be received in 10 to 20 business days. |
| Should we do anything more? | It is good practice to formally approach the tax authorities to explain the company’s background, its activities in Mexico and the origin of the favorable balance. |
| Will our claim succeed?  
  - Do we have the right strategy?  
  - Are our systems robust enough? | The tax refund strategy should be tailored to the company’s situation. When a claim succeeds, it is usually because of a well-planned refund strategy that includes a deep analysis of the company’s transactions, the preparation of an extensive defense file with supporting documentation and a robust follow-up with the authorities. |
| What should we do in the future? | Companies operating in Mexico should plan their operations before conducting them and analyze the implications for indirect taxes, including the likelihood of incurring irrecoverable tax or the need to defend credit claims. They should also verify their compliance with tax and customs and see that they have complete systems and processes that use appropriate technology and data analytics. These activities should aid in preparing successful refund requests in the future. |
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Managing indirect tax refunds
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Indirect taxes, ranging from value-added tax (VAT) and customs duties to environmental levies, affect the supply chain and the financial system. They pose unique challenges to multinational tax functions since they must be managed accurately and in real time. These often invisible taxes can have significant impacts – on cash flow, absolute costs and risk exposures.

Thanks to our network of dedicated indirect tax professionals, who share knowledge and ideas, we can provide seamless, consistent service throughout the world and help you deal effectively with cross-border issues. These include advising on the VAT treatment of new and complex transactions and supplies, and helping resolve classification or other disputes and issues with the authorities.

We provide assistance in identifying risk areas and sustainable planning opportunities for indirect taxes throughout the tax life cycle. We can provide you with effective processes to help improve your day-to-day reporting for indirect tax, reducing attribution errors and costs, and making certain indirect taxes are handled correctly.

We can support full or partial VAT compliance outsourcing, help identify the right partial exemption method and review accounting systems. Our customs and international trade teams can help you manage customs declarations, audit and review product classifications, and evaluate import and export documentation. Our globally integrated teams can give you the perspective and support you need to manage indirect taxes effectively.

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