BDO International
An Introduction to Value Added Tax (VAT)

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Dubai, UAE

Introduction of Ivor Feerick

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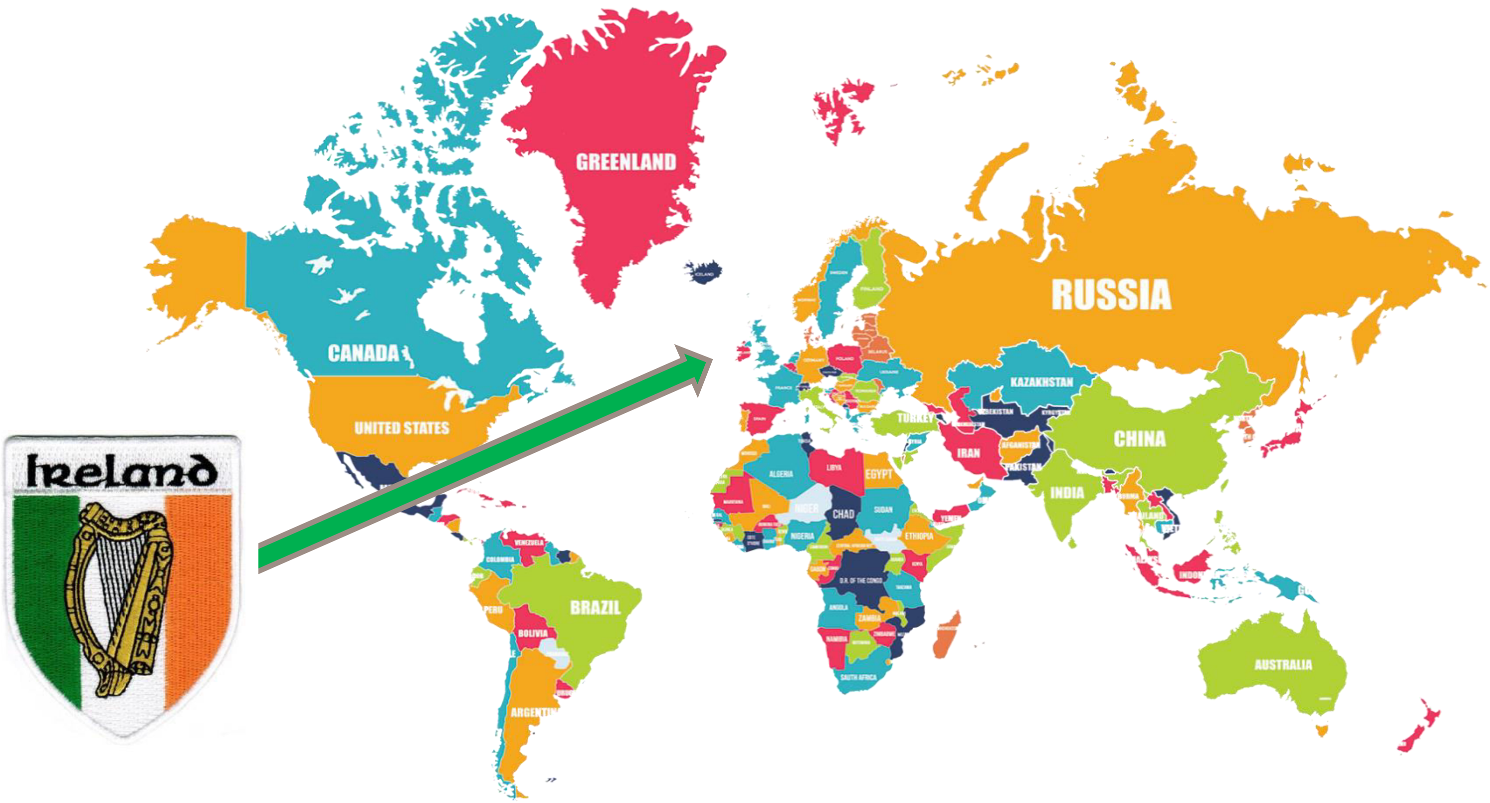
- Previously worked for Irish Tax Authorities for 14 years



BDO International VAT Centre of Excellence Committee

- Chair of the BDO International VAT Centre of Excellence (VCOE)
- VCOE Committee comprises of Head of VAT/Indirect Tax Practices in;
  - ✓ United Kingdom
  - ✓ Germany
  - ✓ Netherlands
  - ✓ Luxembourg
  - ✓ Austria
  - ✓ Switzerland
  - ✓ Belgium
  - ✓ United States of America (Sales and Local Taxes)
- Customs and International Trade & Asia Pacific Sub-groups

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Mission Statement of BDO International VAT Centre of Excellence

"To foster Indirect tax technical and commercial cooperation between the 154 BDO International Member Firms to ensure we best serve the needs of our International clients"

Evolution of Value Added Tax

- Wilhelm von Siemen (Germany) devised the concept of VAT in 1918
- A French economist claimed to have invented the tax itself
- The VAT tax itself (known as TVA) was initially introduced in France by Maurice Lauré (Joint Director of the French Tax Authorities) on April 10, 1954

Evolution of Value Added Tax

- VAT systems currently exist in more than 150 countries worldwide including all (current) 28 European Union Member States

- Generally introduced at relatively low rates (10% in UK in 1973) and then increased thereafter (UK now 20%)

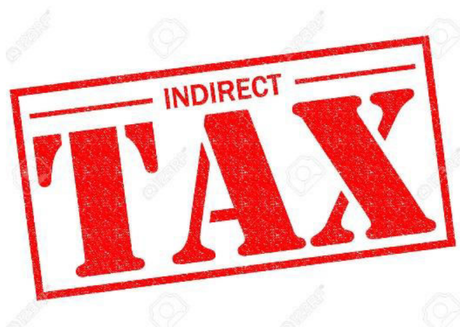
- Each 1% increase in the VAT rate in the UK generates c. £5 billion additional tax revenue for Her Majesty's Revenue and Customs (HMRC)

Why are Governments focusing on Indirect Tax as opposed to Direct Taxes (i.e. Personal/Corporate Taxes) as a means of raising additional tax revenues?

- **Less controversial - effectively consumers have a choice not to buy goods or services so can avoid paying VAT, etc.**

- Indirect Tax rate increase can generate significant additional tax revenues compared to similar increases in Direct Tax rates

- Personal Tax increase can act as disincentive to productivity as employees pay higher taxes as a result of working longer hours



What is Value Added Tax (VAT)?

- Consumption tax on supplies of goods (tangibles) and services (intangibles)
- Most businesses charge VAT and are generally entitled to reclaim most if not all of the VAT they incur which relates to their business activity
- VAT is ultimately payable by the end consumer (i.e. private individuals and entities not entitled to recover VAT)
- Consumers pay VAT as a net cost whereas businesses usually pay VAT and have to manage the related negative cash flows pending recovery of that VAT from the Tax Authorities

Example of Operation of VAT assuming 5% VAT rate

Supply Chain (Goods)

- Supplier sells raw materials to manufacturer for USD $10,000 + VAT of $500

- Manufacturer sells finished product to retailer for USD $18,000 + VAT of $900

- Retailer subsequently sells the goods to a consumer for USD $25,200 (VAT inclusive).

  NB: USD $25,200 inclusive of 5% VAT = $24,000 + $1,200 VAT

- Sales to consumers are generally shown inclusive of the applicable VAT rate as unlike most businesses, consumers cannot reclaim any VAT incurred

Example of Operation of VAT

Supplier
- Sells

$10,000 plus 5% VAT

Raw Materials

Manufacturer
- Purchases

$10,000 plus 5% VAT

- Sells

$18,000 plus 5% VAT

Retailer
- Purchases

$18,000 plus 5% VAT

- Sells

$24,000 plus 5% VAT

Consumer
- Pays

$25,200 VAT Inclusive

- $1,200 VAT paid on total sales price

Supplier		VAT
Sell	$10,000	$500

VAT payable on value added margin: $500

Manufacturer		VAT
Sell	$18,000	$900
Purchase	$10,000	$500
Margin	$ 8,000	$400

VAT payable on value added margin: $400 ($8,000 x 5%)

Retailer		VAT
Sell	$24,000	$1,200
Purchase	$18,000	$ 900
Margin	$ 6,000	$ 300

VAT payable on value added margin: $300 ($1,200 - $900)

Total VAT payable = $500 + $400 + $300 = $1,200

VAT Compliance

- Initial VAT Registration form completed (Sometimes online process)
- Monthly, bi-monthly, quarterly, 6-monthly or annual VAT filings required (filing frequency varies by country)
- Self-assessment system so "taxable person" obliged to ensure filings correct in each country, or appoint an agent to do so

- Specific file and pay deadlines for each country
- Interest generally applies to late payments of VAT
- Penalties generally apply for late registrations, late filings, incorrect filings, etc.

VAT Compliance

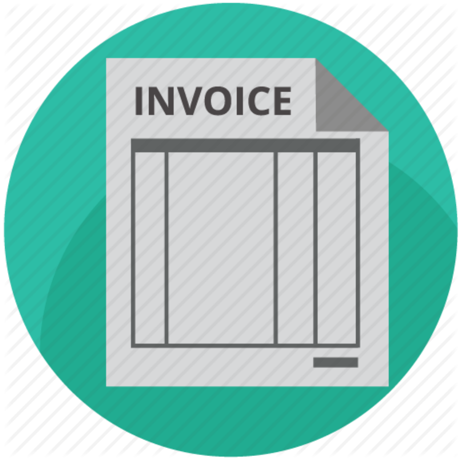
- Generally specified format for VAT invoices, credit notes, etc. to be issued

- Not all VAT incurred is reclaimable, even if all supplies liable to VAT (e.g. food, accommodation, car hire, entertainment, etc.) in various countries

- In some countries VAT can only be reclaimed when invoice has been discharged

- Other Tax Authorities oblige the repayment of any VAT credits previously taken in the event that invoices are not discharged within a certain specified timeframe

Accounting for VAT



a) Invoice Basis

VAT has to be accounted for by supplier based on the date of issue of an invoice, even if the invoice has not been paid before the VAT filing deadline for the VAT period during which the invoice was issued.

Example:
- Invoice issued 5th June for $10,000 + $500 VAT
- Payment received 10th September
- VAT of $500 is included in the VAT filing period ended 30th June

Accounting for VAT

b) Cash/Monies Received Basis

Regardless of the date of issue of a sales invoice, the VAT liability arising only crystallises based on the date/ VAT period in which the related payment is discharged.

Example:

- Invoice issued 5th June for $10,000 + $500 VAT
- Payment received 10th September
- VAT of $500 is included in the VAT filing period ended 30th September

VAT Registration Thresholds

- Each country sets its own VAT registration thresholds and if the annual trading income (turnover) of a business is less than the threshold set, there is no obligation on that business to register for or charge VAT

- Sometimes different VAT registration thresholds arise for;
  a. supplier of goods,
  b. supplier of services, and/
  c. businesses not established in the country of registration (Generally NIL threshold)

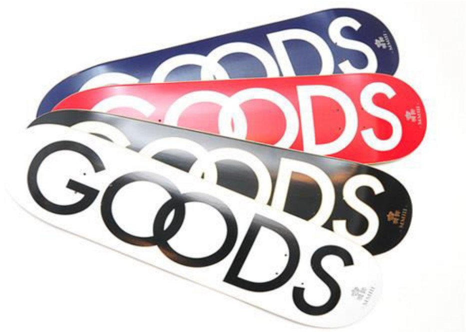
VAT Registration Thresholds

- In some countries businesses whose income is less that the registration threshold set can “elect” to register

- Following on from an “election”, VAT is chargeable and reclaimable similar to a business that has been obliged to register

- Businesses who are not registered, cannot charge VAT on sales nor can they reclaim VAT on purchases

Goods vs Services



- Goods are tangible items and include both moveable and immovable objects other than money.

- Services are intangible and include the performance or omission of any act of the toleration of any situation other than the supply of goods.

- General rule of thumb – if it is not a good, it is very likely to be a service.

Distinguishing between Business (B) and Consumers (C) as Customers

- VAT is a consumption tax payable by the end consumer and most B's that incur VAT as part of a supply chain can generally reclaim VAT incurred on their costs including overheads (e.g. light, heat, electricity, rents, etc.)

- If a B is not obliged to register for or charge VAT, VAT on costs is generally not reclaimable.

- Most VAT systems make a distinction between supplies of goods and services made to other B's and those made to C's, with simplified rules sometimes supplying to cross-border supplies to B's

- Legislation is often introduced to prevent distortion of competition arising on cross-border supplies of both goods and services to C's (e.g. "Distance Sales legislation" and legislation covering Telecommunication, Broadcasting and Electronic (TBE) Services

VAT Exempt vs VAT Exempt with Credit (Zero Rated Supplies)

- VAT systems often exempt certain banking, insurance, financial services, medical and education services

  This means no VAT is chargeable by suppliers of any such services nor is any related VAT incurred reclaimable

- If a business makes both taxable (VATable) + Exempt systems, entitlement to VAT deductibility is more complex with direct attribution of VAT recovery/non-recovery based on income streams from both sources and pro-rata reclaim of VAT on certain dual use costs

- The supply of certain basic foodstuffs (e.g. fruit, vegetables, meat, bread, milk, etc.) is sometimes zero rated/VAT exempt with credit and VAT is fully reclaimable by businesses making any such supplies

Import of Goods

- Generally VAT at appropriate rate is payable at the time of import of goods

  - Correct paperwork is necessary to enable claim of VAT credit/refund.

- Customs duties also need to be considered and if payable are generally not reclaimable

Buying in Services from Abroad

- In most countries, a business buying in services from abroad is obliged to "self-account" for any VAT arising, as opposed to the services supplier having to register for and charge VAT
- This is know as the Reverse Charge procedure under which the recipient of the service accounts for VAT based on the rate of VAT applicable on the service in the country in which the business is established. Credit for this VAT can be taken subject to normal rules
- Special rules apply to services relation to immovable goods/property

Bad & Forgiven Debts

- **Bad-debts**
  If VAT is charged on supplies of goods or services and debt is not discharged due to insolvency, bad-debt, etc., credit can sometimes be taken if Tax Authorities are satisfied that all reasonable efforts have been made to recover the debt - only applies if supplier is on "invoice basis"

- **Forgiven debts**
  If a supplier does not pursue a debt for a good commercial reason, VAT credit can also be taken in certain circumstances.

  Credit notes are generally issued if agreed price reduction between the vendor and the customer

Conclusion

- VAT systems are generally a very effective and efficient means of collecting significant tax Revenue around the world

- VAT compliance systems are now online in most countries

- VAT is a Self-assessment system under which businesses are obliged to submit correct returns and pay liabilities in timely manner

- VAT systems are policed through regular tax audits and the ongoing monitoring of exceptional trends by the Tax Authorities across the globe

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