Executive summary

Managing indirect tax controversy
Dealing with audits and disputes
In recent years, issues related to managing indirect taxes — such as VAT, GST, customs and excise duties — have risen higher on the corporate agenda. What factors have brought these taxes and duties to the attention of C-suite executives?

External drivers
Indirect taxes are growing in importance as sources of tax revenues and instruments of governmental policy. As a result, tax and customs administrations are focusing more attention than ever on indirect tax compliance and enforcement.

At the same time, the “fair tax” debate has turned a spotlight on corporations’ tax affairs generally. Initially, attention focused on direct taxes; now the debate has now expanded to include questions such as: how should VAT/GST apply to cross-border transactions and the digital economy? What is the interplay between customs valuation and transfer prices? These topics are drawing far greater attention not only from tax administrations, but also from regulators, the media and the general public. Large tax assessments can damage corporate reputations as well as profitability.

Internal drivers
Businesses around the world are under pressure to improve financial performance. And they are increasingly aware of the intense scrutiny they face from a range of internal and external stakeholders. In the process, they are asking more of their tax and finance functions, challenging them to reduce risks and meet the company’s obligations more effectively, using limited resources.

These functions are being asked to go beyond tax compliance and tax accounting. They are being asked to contribute to companies’ financial performance by reducing costs, facilitating processes and improving cash flow. Increasingly, tax and trade functions are also actively participating in strategic decision processes to provide financial and nonfinancial impact analyses.
Indirect tax controversy matters

Controversy involves dealing with audits and disputes, but it goes much further. It also includes actively managing tax issues to reduce risks and improve performance. The consequences of controversy – and the business drivers for avoiding or resolving it – are particularly strong for indirect taxes. Getting everything right all the time and in every country is hard. Errors, uncertainty and disagreements abound – often leading to assessments, penalties and disputes that go far beyond the tax or finance function.

- A dispute with customs may not just be about taxes – it can mean genuine business disruption: customs can seize a trader’s goods or shut down operations; even a delay of a few hours for an unexpected customs inspection can breach contractual conditions for just-in-time deliveries or hold up valuable production schedules.
- Uncertainty about charging VAT/GST can be costly for the wrong party: most VAT/GST registered businesses are not the final taxpayers; rather, they collect and remit the tax due from their customers – effectively, they act as tax collectors. Not charging tax, or not charging the right amount of VAT/GST at the time of sale, can be costly. If tax is later deemed to apply to the sale and the charge cannot be passed on to the customer, the tax collector can become the taxpayer – funding the VAT/GST out of its profits.

Actively engaging with the tax agenda, anticipating future audit activity and developing a strategy for dealing with controversy can reduce the impact of inspections on day-to-day operations and improve audit outcomes.
Audits and inspections are a regular and inevitable aspect of managing indirect tax controversy. They may happen at any time and can be highly disruptive if the business is unprepared.

Preparing to meet the challenge of difficult tax audits and customs inspections involves the whole business, not just the tax or trade function. It requires an understanding of the risks that indirect taxes can pose and an investment in technology, IT, people and processes to improve and maintain good compliance and reporting.

Risk-based audits
Taxpayers or shipments may be selected at random. But increasingly, tax and customs authorities are targeting their activities based on risk. Triggers for an audit may include factors such as errors in documentation, unusual patterns of trading, large numbers of refund requests, trading at a loss for an extended period or trading with other companies that have previously engaged in fraudulent trading.

In 48 out of 82 countries surveyed, tax audits have increased in the last three years.

Our survey indicates that tax administrations in 56 countries share VAT/GST information with other government departments (such as customs, transfer pricing and social security), and 51 countries share VAT/GST information across borders.
Data is driving audits

Tax and customs administrations are using data to target their resources to address risks and tackle tax leakage and tax avoidance. By harnessing the power of technology, they are carrying out more audits and uncovering more errors – leading to higher assessments and penalties.

Nowadays, any VAT/GST or customs audit could be an e-audit. Failing to keep pace with e-audit regulations and documentation rules can increase both tax and business risk. Businesses can prepare for e-audits and inspections by knowing their data obligations, adopting and documenting data policies, understanding audit processes, and carrying out their own checks and reconciliations on a regular basis.

In 59 out of 82 countries, our survey revealed that the tax administration uses electronic data extraction to perform tax audits.

In 72 out of the 82 countries surveyed, tax administrations carry out off-site audits using data submitted by taxpayers through their VAT/GST returns or using data taken from taxpayer’s accounting systems.
Penalties

Errors uncovered during an audit may lead to penalties, fines or even seizure of the goods. Penalty amounts may be high (up to 800% in some countries) and they can quickly add up, even for minor mistakes, as fines are often calculated based on the gross amount of an error or on the number of documents on which an error was made, and assessments may span many years.

In our survey, 42 of 82 countries reported that the risk of incurring penalties for VAT/GST errors has increased in the last three years. However, 68 of the 82 countries we surveyed allow a reduction in penalties if taxpayers declare errors themselves.

Disclosure
Dealing with audits and disputes
Managing indirect tax disputes effectively requires specialist skills and experience. Recognizing this fact, many taxpayers seek professional assistance, especially if matters proceed to court. Getting specialist advisors involved early in the process can increase the chances of a speedy and cost-effective resolution.

Resolving issues out-of-court

Many people assume that litigation is the only way of resolving tax disputes. While litigation is one possible course of action, alternatives should always be explored before heading to court. Depending on the jurisdiction involved, options may include: tax authority review, negotiation and mediation.

Litigation

If negotiations are not possible or have broken down, litigation may be the only way forward.

Some cases could be resolved at the first appeal, but others may take years to resolve, and may involve hearings and decisions at several levels of the judicial process. At all levels, detailed evidence and robust submissions are key factors for success.

Going to court may help to reach a definitive ruling on difficult or unclear legislation, which is then binding on other cases. This aspect of the process can benefit tax administrations as well as taxpayers – and may be a motive for taking a case in the first place. Keeping abreast of current and impending tax cases can help taxpayers to anticipate possible changes in tax laws and even identify opportunities to challenge past tax administration rulings.
Dealing with indirect tax disputes

In 48 of the 82 countries respondents stated that most taxpayers in their countries were reluctant to take disputes to court.

Avoiding disputes

The best way to manage indirect tax penalties and disputes may be to avoid them! Achieving full compliance requires a combination of knowing the indirect tax rules and applying them correctly.

Clarifying the rules

Indirect tax rules are not always clear, or the taxpayer and tax administration may disagree on their interpretation. Change can add to the uncertainty.

But taxpayers are not powerless in the face of ambiguity. Many tax and custom authorities provide guidance and offer binding advanced rulings. Taxpayers can also engage in tax policy discussions — either as individuals or as groups.

Many countries encourage input from taxpayers and their advisors on the design and impact of new legislation about the workings of the tax system. The EU Commission, OECD and WTO all provide platforms for businesses and their advisors to engage actively with tax administrators on these issues. Participating in these discussions can not only help to clarify the law, it may also result in genuine improvements.

Applying the rules throughout the chain

Knowing the indirect tax rules apply to their activities is not enough for taxpayers to avoid disputes; they must also apply the correct treatment for every activity throughout the end-to-end accounting process — from record to report.

50 countries in our survey answered that their primary legislation changes once a year or more frequently.

72 countries surveyed provide for a formal or informal consultation process ahead of new legislation.
Often, there is a lack of clear ownership around indirect taxes, particularly from a compliance or financial statement perspective. No one person or department is responsible for the end-to-end process, and different parts of the business may expect others to pick up the responsibility, resulting in operational gaps.

Tax, trade and finance functions must collaborate in this process to ensure there are no weaknesses and gaps. They must work with one another and with other functions within the organization (for example, legal and IT) and with third parties (for example, customs brokers). C-suite executives can also play a key role in ensuring that indirect taxes are managed responsibly within their organizations by assigning responsibilities and resources to these functions.

Managing indirect taxes can prevent small mistakes becoming large risks. It requires clear responsibilities, efficient systems, documented processes and robust controls. It involves thinking about controversy in every phase of the tax life cycle – tax compliance, tax accounting and tax planning – to identify and rectify issues before they become the subject of a tax dispute.

Respondents in 45 out of 82 countries reported an increase in companies appointing a person responsible for VAT/GST in the last five years.

Find out more
Read our full report, including our audio discussion of the issue of e-audits at www.ey.com/inindirectcontroversy.
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About EY's Indirect Tax services
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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