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# VAT determination: avoiding the domino effect

This article provides an overview of value-added tax (VAT) determination, its significance for businesses, some of the challenges related to determining VAT and using technology for arriving at the correct amount of VAT accurately.

## What is VAT determination and why is it important?

VAT determination allows organizations to identify business scenarios where products and/or services are taxable and accordingly, the applicable tax rate and tax point. In layman's terms, your business process needs to be able to define who bought the product/service, what product/service was purchased, when it was purchased, where it was purchased and how much was paid for the product/service. This information is subsequently used to determine how much VAT is due to be paid on the transaction in question and who is responsible to pay the VAT.

However, there are multiple variables when you are trying to determine the amount of VAT to calculate and charge on the sale of your own sales of goods and services, also known as your output VAT. It is a common misconception that these variables are defined in the tax law or regulations; however, this is not the case. When governments introduce indirect taxes such as VAT, the regulations are for the masses and can be likened to a framework where the main structure is defined and organizations then need to tailor the regulations around their own business processes to be able to fill in the blanks. Failure to do so could lead to incorrect calculations which subsequently could result in an incorrect tax return, which in turn, could attract a fine.

If we look at the technology journey of the VAT lifecycle, the first and the most important step for organizations is to be able to configure their VAT determination process correctly. Accurate VAT determination should result in the correct VAT treatment for each transaction and subsequently, the rest of the VAT lifecycle is set on a firm foundation. This will allow organizations to collect and subsequently pay the correct amount of VAT on each transaction, which in turn, will help you arrive at the accurate amount to be paid to the tax authority. In addition, correct VAT determination comes with additional benefits such as reduced risk of cash leakage, which consequently results in better cashflow management, accurate reporting and improved compliance and risk processes.

## Why VAT determination can be a challenge

VAT determination can be a challenge for a multitude of reasons. Some of the most common challenges include:

1. **Inadequate data on application of tax rules:** As VAT has recently been introduced in the region, there is not enough precedent for certain cases, which makes setting tax rules

difficult in some instances. As an example, in the UAE, there was considerable confusion on the treatment of dividends and the management fee of said payments until the FTA published an official clarification in 2022 stating the dividends are not subject to VAT but the management of the payments are.

2. **Complex IT landscapes:** Organizations with complex landscapes that include multiple systems with multiple data points often have issues consolidating data into a tax engine or any other system where VAT determination takes place.
3. **Complexities pertaining to tax codes:** Although some organizations may have a tax engine or have their ERP configured to accommodate tax codes, it is often the case that tax codes either do not exist, are too complex or are mapped incorrectly.
4. **Frequent changes:** VAT regulations can change frequently, which can make it difficult to stay on top of the latest requirements. This may result in errors and noncompliance.

In addition to the above, there are other factors that can also make VAT determination a challenge. When multiple issues exist, they have a compound effect — think about trying to unravel fairy lights that were put away during the last holiday season and are now in a tangled ball.

## Compound effect of wrong VAT determination

A tax point determines when tax is due and without determining the tax points correctly for every business scenario, organizations may have to deal with calculation errors. While controls such as the format and percentage to name a few would pass, the reporting may be incorrect, including important items such as tax returns and management reporting, just to name a few. Below is an example of the domino effect, which can occur when VAT determination goes wrong. If we take the same scenario and multiply it by hundreds of transactions, this could have a significant impact on cashflow.

### Example scenario A

- "Customer A" placed a deposit of AED105 for a service on 24 January 2022 from "Organization B," an organization based in the UAE.
- The total amount for the service is AED1,050 (inclusive of VAT) and the service is due to be delivered in March 2022.
- Initially, Organization B was declaring the full amount of VAT of AED50 upon receipt of the deposit in their January VAT return as they believed they had to pay the complete amount on receipt of a deposit.
- However, only AED5 was due to be paid in the January VAT return and the remaining AED45 would be due in the March tax return upon completion of the service.

Many organizations believe that the above can be resolved with "tax codes;" however, this at times can complicate the situation even further. As an example:

### Example scenario B

- An organization in the UAE that operates in a single emirate and sells "Standard Rated" supplies only.

Most people will treat this scenario as a simple one, as the assumption is that only a couple of tax codes are needed as there would be a single output box and a single input box. However, codes are also required for any taxes being claimed back under the bad debt recovery scheme. This means an organization will need two codes for a single output box

on the VAT return. Additionally, if the data originates from multiple systems, the organization may want to keep the tax codes different to help easily identify the originating system. Now, there are potentially four tax codes for a single output line.

If the organization then decides to open in additional emirates, the result could be 12 tax codes. Being able to track reverse charges is another important factor, which results in another "X" number of codes. The list of codes can go on indefinitely, therefore, it is important to receive guidance throughout this journey to avoid ending up with a web of codes.

## How do I select the correct technology?

Technology solutions can help automate the VAT determination process. There are a range of solutions available and picking the right solution depends on many factors, such as your existing IT landscape, budget, and your overall tax transformation strategy. EY's Tax, Technology & Transformation (TTT) team can assist you in selecting the correct technology that matches the needs of your organization.

One of the available solutions for organizations is an offering from our alliance partner Thomson Reuters – ONESOURCE Indirect Tax Determination (OITD). OITD comes with ready content for over 205 countries across the globe, which is managed and maintained by the Thomson Reuters team. Therefore, any updates in regulations or legislation that impact your determination are automatically updated. OITD has certified integrations for SAP, Oracle and Microsoft, which makes the solution very easy to connect to your existing IT landscape. The solution is available both as a cloud offering and on premise; and has been deployed in multiple sectors such as FMCG, oil and gas, banking, finance and manufacturing, to name a few. In addition, if you have a highly complex landscape with multiple systems, it can become your single source of truth, as OITD can connect easily to multiple systems.

Furthermore, EY is a Diamond tier ONESOURCE Certified Implementer Program organization. Combining ONCESOURCE OITD with the existing technologies, deep tax experience and connected global network of the EY organization will help us guide clients as they embark on digital and business transformation to simplify tax processes, reduce operating costs and maintain transparent global tax compliance.

## Why work with EY?

Taxes and tax-related processes are becoming technologically advanced and often drive business transformation. The EY TTT team helps clients realize transformational benefits through, system integration and business integration for tax by transforming tax functions into intelligent tax functions. TTT operates as one connected team across the globe with physical hubs in key markets, including MENA. With EY teams across EMEIA, we will be able to assist you in your tax transformation journey. This in turn means that you get access to professional assistance in every jurisdiction that EY operates in.

With all the recent indirect tax developments and rapid overall digitization of tax processes in MENA, EY TTT and Indirect Tax professionals work hand-in-hand. Together, we are implementing effective indirect tax solutions for multiple organizations across the world. Furthermore, the TTT team works very closely with our alliance partners to ensure that we are always at the forefront of technology, to be able to recommend the best-fit solution for your organization.

In the upcoming articles, we will focus on data quality management, managing VAT reporting and VAT controversy.

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