



# Global Impact: How VAT Affects Your Overseas Business

## 5 rules every U.S. company should know about selling internationally

Often overlooked, misunderstood, unrecognized or flat out disregarded, Value Added Tax (VAT) has an enormous impact on U.S. companies that do business overseas. Enforced in more than 150 countries around the world, VAT is a form of indirect tax imposed on products and services at different stages of the manufacturing and supply chain.

While VAT and sales tax might seem similar, they are in fact, quite different. Where the two are alike is that both are complex and, like sales tax, not understanding or adhering to VAT rules and regulations can make or break a sale, increase risk, and even ruin a company.

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“VAT can be very material to your business,” says global VAT expert, Mark Houtzager, principal consultant at US VAT, Inc., a provider of VAT support for U.S. multinationals. “If you look at the VAT amounts that need to be managed throughout the accounts of any company outside of the United States, they can be anywhere between 25 and 40 percent of a company’s gross turnover,” notes Houtzager. “So, if there are any errors or inaccuracies in filing or if savings opportunities are not identified, the impact on the bottom line can be significant.”

Houtzager advises businesses looking to expand their sales operations overseas to talk to their accountants. “As trusted advisors, your accountant should know about VAT and be able to help you understand your obligations.” This counsel should include being pragmatic about how VAT could impact the company’s overall growth strategy and how to integrate VAT compliance into business practices in a seamless, economical and practical manner.

**What is VAT and how does it Work?**



This short whiteboard video illustrates how VAT is applied at each stage of the production cycle.

**How VAT Works**

Almost every country charges some form of VAT, sometimes called Goods and Services Tax (GST) or consumption tax. Like sales tax, VAT is due on purchases and sales of goods, services and intangibles, such as royalties and licenses. However, while U.S. sales tax is based on the total retail value of the item and paid by the end user, VAT is collected at each stage in the production process based on the value of the goods or services at that time. Businesses are allowed to credit the VAT that they incur on their purchases, so that by the time the product or service reaches consumers, VAT on the full retail sales price is due.

**EUROPEAN UNION (EU) COUNTRIES  
(ALL MEMBER STATES FALL UNDER THE EU VAT REGIME):**

Austria	Germany	Poland
Belgium	Greece	Portugal
Bulgaria	Hungary	Romania
Croatia	Ireland	Slovakia
Cyprus	Italy	Slovenia
Czech Republic	Latvia	Spain
Denmark	Lithuania	Sweden
Estonia	Luxembourg	United Kingdom
Finland	Malta	
France	Netherlands	

European countries not part of the EU that apply VAT are Switzerland, Liechtenstein, Iceland (currently a candidate for EU membership) and Norway. (Also note that the European Union is different from the Euro-zone. The United Kingdom, for example, is a member state of the EU, but not part of the Euro-zone.)

VAT is traditionally administered by and remitted to the taxing authority of a particular country. The exception are goods imported into a VAT country, in which case VAT is remitted to customs. VAT on imported services is also administered by the local authorities because import VAT in the standard sense does not apply to intangibles. To cover and collect VAT on services, most countries apply the so-called “reverse charge,” which means that the VAT on imported services is collected from the recipient instead of the service provider. Typically, this reverse charge only applies to business customers, who must report these imports of services on their regular VAT return.

Like U.S. sales tax, the consequences of doing VAT wrong can be costly. Penalties include:

- » Sellers who fail to make tax payments must repay all of the tax owed, plus interest and fines of up to 200% of the total VAT liabilities.
- » Company officers can be personally liable for the company’s VAT liabilities and could face imprisonment if it is discovered that the company is not VAT-compliant.
- » VAT can be backdated up to seven years along with interest on unpaid VAT, penalties and interest on the unpaid penalties.

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“I had a couple of clients in the online services industry who initially ignored VAT,” divulges Houtzager. “When the companies were up for an IPO or an acquisition, due diligence revealed they didn’t report or withhold VAT due on their sales. As a result, they inflated their overseas sales numbers by 20 to 25 percent (the applicable VAT rate) and accrued penalties and interest as well,” he adds. “Believe me, a VAT auditor could not be happier seeing a ‘voluntary disclosure’ of a couple of million dollars!”

## Understanding Exemptions

U.S. companies familiar with sales tax exemption will find VAT exemptions are somewhat different. Exempt sales are more broadly applied in the U.S. and require buyers to provide exemption certificates. If the buyer is reselling the goods purchased, a resale exemption applies on the purchase.

VAT exemptions are applied at the final sale to the consumer. Exempt transactions include activities relating to the public interest, including medical care, education and postal services, as well as some insurance and financial services. For example, the bank may charge VAT on services like consultancy, but on the interest of a loan, VAT is not charged.

If a business purchases goods or services and the vendor charges VAT, a refund or rebate of that tax may be due. These VAT reclaims can be made on the regular periodical VAT returns filed by businesses.

For U.S. companies that aren’t VAT registered and have no registration obligation, there is a separate procedure to reclaim VAT incurred. This is only available in a limited number of countries. For businesses selling online goods to buyers in the EU, the tax rules vary. If the buyer is the importer, VAT is paid at the time the goods are received.

## Registration and Filing Requirements

Registration rules and procedures on VAT can be rigorous and complex. For example, if a U.S. company:

- » Owns or rents a warehouse or has inventory in the European Union (EU), then the company is required to register in the country where the warehouse is located.
- » Sells goods to a buyer in the EU and the buyer is the importer of the goods into the EU, then no registration is required; the buyer would pay VAT at the point of import.
- » Sells services to an EU business, then no registration is required. Where the buyer is a private individual making purchases of certain online and other services, such as downloads of software, video or audio files, then the U.S. seller must register for VAT in the EU.

Companies doing business overseas can also incur steep fines and penalties for late or missing registrations, failure to account for the correct amount of VAT or accounting for VAT in the wrong country.

Some expenses may be exempt and not qualify for a refund, which can become an issue for companies trying to set up shop overseas if they don't understand this, says Houtzager. "VAT on exploratory expenses isn't always refunded. And, at around 20 percent, this is substantial and may not be a cost a company anticipated absorbing."

"A few years ago, a large manufacturer of consumer electronics in the Far East planned to set up major manufacturing operations in Spain," he explains. "The company had nearly finished its negotiations with the national and provincial governments, but asked that approximately \$5 million in VAT paid to service providers for research, advice, testing and similar expenses be refunded."

At the time, there was no legal process in place for the Spanish government to do that says Houtzager. As a result, the company withdrew its plans to do business in Spain.

Before doing business overseas, U.S. companies should have at least a basic understanding of how VAT works in order to build tax obligations into their planning and avoid financial surprises. Here are five key things that every seller should be aware of when it comes to VAT compliance.

## Five VAT Practices That Could Affect Your Business



### The Invoice Dictates the Terms of the Transaction

Invoicing plays a crucial role in VAT compliance. The **sales invoice** stipulates the VAT due on your sales. The **purchase invoice** validates the amount of VAT that is creditable on your purchases. The invoice must show important data points, which include the name and address of both the buyer and the seller, a sequential number and amounts in the

currency of the country where the sale takes place. The currency requirement, in particular, is often a trap for U.S. companies; because companies are often paid in U.S. dollars, they are unaware that the invoice must show the various amounts in local currency and will also often be obliged to use locally set or pre-approved exchange rates.

## 2

### **Know What You Owe**

VAT can make or break your access to overseas markets, especially if you're a retailer. Preparation and awareness are key. Take for example, Amazon marketplace sellers who thought it would now be easy to sell to European customers, but didn't realize the full financial implications of VAT.

"If these sellers would have realized early on that there is a 15 to 27 percent markup for VAT- payable by either the seller or by the buyer-they would have been able to plan their new sales," explains Houtzager. "For example, they could have decided to sell only low-value goods on which no import VAT is due."

## 3

### **Tax Triggers**

Most companies doing business overseas have a physical presence in one or more foreign countries—a sales office, warehouses or inventory, for example. Even if the business isn't operating locally, the mere fact that it is importing goods and selling locally may trigger a VAT obligation. This is an important aspect for U.S. companies doing business internationally. When a non-resident business imports goods, local customs will claim tax, often through the courier. The courier will then turn around and charge the seller for the tax. By then, a registration requirement for the seller often exists, even if the seller does not have a local legal entity. Additionally, without this registration the seller will not be able to recover the import VAT they have incurred and will be forced to treat it as another cost.

## 4

### **Defending the Zero-Rate**

VAT countries typically apply a standard rate for most supplies of goods and services, a reduced rate for basic necessities such as food, and a zero rate for exports. However, much like sales tax in the U.S., tax authorities want to collect as much VAT revenue as possible and will challenge that zero-rate at the time of an audit.

Businesses must be able to prove that the goods and services they provide have been exported. If the customer is outside of the European Union (EU), proof is in the form of export documents that accompany the goods and are certified by a customs official. However, if the sale is cross-border within the EU, that's harder to prove as there are no fiscal borders within the EU. In these cases, it is important to have documents on hand to demonstrate that the seller has transported the goods to the buyer or—even better—that the goods have arrived at the buyer's location in the other EU country.

## 5

**Defending the Zero-Rate**

What if a U.S. company simply chooses to ignore VAT? That could prove costly. The VAT incurred on all purchases and imports, which make up for 15% to 27% of the cost, will not be recoverable. This, in itself, already forces companies to comply with the VAT rules. However, even from the perspective of the company's customer, VAT compliance is important; if the bona fide business customer does not receive a valid VAT invoice, the customer won't be able to recover the VAT on the purchase, either. Finally, filing a timely, correct and complete VAT return is important for the company's credibility. Having the company's CEO detained at the airport because of tax irregularities is a controller's nightmare.

**Mitigate Risk with Automation**

Like sales tax, VAT can be complicated and time-consuming to undertake. It can also create risk for a business if not managed correctly. If you have questions about VAT, a good place to start is with your accountant who has intimate knowledge of your business and should be able to assess how VAT regulations could impact your selling practices and advise on ways to integrate VAT compliance into your existing financial practices. If you already automate sales tax in your accounting system, ERP or ecommerce system, adding VAT compliance should be fairly straightforward. If you haven't yet automated tax compliance, this might be a good time to consider it. VAT shouldn't be ignored, but managed correctly, it doesn't have to be a barrier to entering new markets

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**Case in Point**

A U.S.-based manufacturer and distributor of pharmaceuticals rented a distribution center in Italy to supply to Italian pharmacies. The company had to pay VAT at the time that its goods were imported from the U.S. into Italy.

The company paid the 20% on the value of its Italian inventory to Italian customs (the VAT rate in Italy at that time). However, the company did not collect VAT on sales to the pharmacies in Italy due to the reverse-charge applicable for non-resident companies that sell domestically.

Italy has been historically slow to refund VAT to taxpayers; some non-resident taxpayers have waited up to five years. Because of the delay, the U.S. company could not offset the credit for the import VAT against the liability for the domestic sale, verily increasing the price of its goods by 20%. As a result, the company moved the entire inventory to the south of France—just across the border from Italy. France's warehousing costs were slightly higher than Italy, but the 20% VAT savings justified the move.

**About Avalara**

A privately held company, Avalara was founded by a team of tax and software industry veterans to fulfill a vision of delivering an affordable, scalable sales tax solution. Thus making what was not economically feasible in the past for mid-sized business not only affordable, but more accurate as well – all with the latest and most innovative technology available. From Bainbridge Island, close to Seattle, Avalara's knowledgeable staff works tirelessly to help customers put the hassles of sales tax compliance out of mind. Avalara's mission is to transform the tax process for customers by creating cost-effective state-of-the-art solutions. The company does so through integrated on-demand, Web-based software services that provide transparent transactions, accurate tax compliance, painless administration and effortless reporting.