INSIGHT: Managing Global Indirect Taxes During Covid-19—An Overview of Savings Opportunities and Unintended Consequences

By Philippe Stephanny and Elia Galli

With the coronavirus (Covid-19) spreading across the globe, daily lives and the global economy are unraveling. While some restrictive measures appear to be slowly rolled back, cash flow management is more vital than ever for businesses. Traditional methods of optimizing cash flows generally revolve around changing payment terms. In addition to these traditional methods, businesses operating in jurisdictions with a value-added tax (VAT) or goods and services tax (GST) (collectively referred to as “VAT” hereinafter) must pay attention to the impact these taxes have on the current cash flow.

In a perfect VAT system, VAT should be neutral for businesses because businesses would offset VAT paid on purchases (input VAT) against VAT collected on sales (output VAT), and the net VAT amount (i.e., output VAT less input VAT) would be paid to the government. Importantly, in most regimes, this would occur before the business received any cash from the customer. As a consequence, over the past several years, indirect tax executives have become increasingly aware of the impact of indirect taxes on the working capital of their companies. Moreover, even before the current events, there was a rising perception that the overall impact of VAT on a company’s cash situation is negative. The importance of this situation is understandable given that the average standard VAT rate in Organization for Economic Cooperation and Development (OECD) jurisdictions is 19.3%. Moreover, the OECD observed recently that VAT could be an effective tool for countries to raise additional revenues should that be deemed necessary. Companies should thus pay close attention to their VAT throughput (i.e., the total amount of output and input VAT managed on behalf of the tax authorities).

As countries around the globe are battling the virus, they are adopting special measures to alleviate the burden of VAT on businesses. Moreover, multinational enterprises can leverage existing VAT rules to their advantage to mitigate those issues or even improve cash flow. Finally, as a consequence of the Covid-19 epidemic, businesses may enter into unusual transactions for which the VAT treatment should be carefully reviewed.

LEVERAGE URGENT COVID-19 MEASURES ADOPTED BY COUNTRIES ACROSS THE GLOBE

With the outbreak of Covid-19 and the related economic slowdown in most countries, governments across the world have adopted urgent measures to ease the burden of taxes, including VAT, for businesses. These measures vary from country to country and may include filing and/or payments extensions, reduction in late payment and filing penalties and interest, more flexible timeframes for response to tax authority audits, faster VAT refunds, reduction of VAT rates for certain products and services, and special import measures.

While it seems that the most widespread measures introduced by governments are deferrals for VAT filings and payments (e.g., in Belgium, Denmark, India, the Philippines, Saudi Arabia, and Turkey, among others) not all countries provide such relief. Russia, for example has implemented such a direct tax relief, but has explicitly excluded VAT filing and payment postponement from the relief measures.

Some countries will grant a postponement of VAT payments, but taxpayers are still required to file VAT returns timely. In the U.K., for instance, VAT payments...
between from March-June 2020 can be deferred until March 30, 2021, with no special communication of this choice to HMRC and without incurring late payment penalties and interest. However, VAT returns must be filed by the regular deadlines. The Netherlands takes a slightly different approach as the tax authorities will grant a three months deferral of payment for any taxes, including VAT, upon request of the taxpayer. Taxpayers may further request payment deferrals of more than three months if they can substantiate that they encountered financial difficulties due to the current events. Once the justification has been received, the Dutch authorities will put the collection of tax on hold, and a case-by-case assessment will take place at a later date.

A few jurisdictions that maintain their filing and payment deadlines have issued guidance clarifying that the tax authorities would not impose late payment penalties or interest. In Luxembourg, the tax authorities did not impose penalties for late filing of VAT returns (the measure expired on May 12, 2020), while in New Zealand the Inland Revenue is allowed to write off interest for those experiencing adverse financial impacts from Covid-19 for tax payments due after Feb. 14, 2020.

Covid-19 has also affected audits and other tax procedures. Ecuador, for instance, initially published a Presidential Decree that suspends the terms of all tax administrative processes and the statute of limitations for collection actions from March 16, 2020, to March 31, 2020, which has been further extended. Similarly, Kazakhstan has suspended all tax audits for the duration of the state of emergency that has been declared as a result of Covid-19.

In addition to broad compliance and tax procedure measures, some countries have also adopted more targeted measures to support either the Covid-19 relief efforts or industries especially hard hit by the economic impact of various confinement measures instituted to reduce the spread of the disease. Several jurisdictions, including Brazil, Jamaica, and Ukraine, provide for an exemption from VAT and/or customs duties for imports of necessary medicines and medical equipment. Industries most often targeted by special measures include the tourism and restaurant sectors. Malaysia provides specific relief to the tourism sector by exempting hotels from the 6% service tax. Similarly, Moldova reduced the VAT rate applicable to the hotel, restaurant, and catering sector, while Norway reduced the VAT rate applicable to cinema admission, public transport, and hotel accommodation services. In other jurisdictions, the VAT relief measures are only targeted at small and medium enterprises. This is for instance the case in Chile where only companies with approximately less than $11.6 million in revenue can apply for a deferment of their VAT payments.

To address cash flow impacts, several countries have announced they would provide VAT refunds more quickly. Businesses may be in a VAT refund position if their input VAT exceeds their output VAT. This could be the result of the taxpayer regularly exporting goods or not being able to sell their inventory. Greece, for instance, announced that it would accelerate VAT refunds when the refund amounts do not exceed EUR 30,000 per taxpayer, while in Indonesia VAT refunds have been accelerated for corporate taxpayers in 19 specific sectors affected by Covid-19.

As the spread of the virus and its economic impact is fluid, countries are continuously updating their tax measures as the situation in that given jurisdiction unfolds. Most VAT relief measures adopted initially adopted are for a short time, with countries being required to extend their application as the situation unfolds. This is for instance the case in Israel where the initial VAT return filing deadline extension has been further extended to May 25, 2020. Taxpayers should thus continuously monitor these developments either by subscribing to various newsletters or, in the jurisdictions where they have major operations, tracking news developments on the tax authority and ministry of finance website. Moreover, taxpayers should carefully review the measures adopted to see if they fit the specific conditions and that they do not misunderstand a particular relief measure. For instance, in jurisdictions where VAT payments can be deferred, taxpayers should review whether the deferral is interest free and for how long, as well as whether returns still need to be submitted timely. Unfortunately, in most jurisdictions these concessionary measures do not apply to remote sellers of digital products and services who are registered for VAT purposes, but do not have a physical presence.

Finally, it should be noted that once the situation stabilizes, countries will have to ensure that they have sufficient revenues to pay for all the relief measures (tax and others) implemented during Covid-19. In this respect, countries may look to VAT to replenish their coffers. This is for instance already the case in Saudi Arabia, which recently announced that it will increase its VAT rate from 5% to 15% effective July 1, 2020.

### ACTIVELY MANAGING VAT CASH FLOW SAVINGS OPPORTUNITIES

#### Output VAT Optimization

One of the major issues relating to cash flow on sales is the discrepancy between standard accounting rules and VAT rules. The challenge arises from the determination of when VAT is due to the state. In VAT terminology, this is referred to the “tax point,” which can vary based on such factors as the date of delivery of goods or performance of services, the date the invoice is issued, and the date payment is received.

Companies can use the VAT tax point rules to their advantage to reduce the cash flow impact VAT may have. In some countries, it is possible to defer the tax point from the moment the sale is performed to the moment the invoice is issued. In the Netherlands, for instance, an invoice must be issued for certain transactions within 15 days of the calendar month following the month in which the sale of goods or services was made while the output VAT has to be remitted on the return for the month in which the invoice is issued. Consequently, at the end of the month taxpayers may delay the issuance of an invoice so that the VAT will be accounted for in a later tax period. The following example will illustrate the benefit of delaying the issuance of an invoice. Company A, who submits monthly VAT returns, sells goods on April 25. Company A would thus need to account for and pay VAT in its April return that is due in May. By setting up its systems so that company A issues the invoice beginning of May, VAT would only be payable in the May return, which is due in June.

Moreover, in certain countries it is possible to issue a request for payment instead of a tax invoice. The differ-
ficiency between a request for payment and a tax invoice is that the request for payment does not trigger the tax point, and the taxpayer is only required to declare and pay the VAT when payment is received. In Belgium, where requests for payment are allowed, the tax point is triggered either by the issuance of the invoice or the receipt of payment. Therefore, a business sending a request for payment can delay the payment of VAT to the tax authority as long as the request does not state any VAT amount, and subject to the limitation of issuing VAT invoices within the required time limit.

Many countries allow sellers to issue electronic invoices. While electronic invoices as such do not affect cash flow, they offer significant cost savings compared to paper invoices. Taxpayers may also use self-billing where the local legislation authorizes it. Under self-billing, the customer issues an invoice for the seller, which allows the customer to influence the timing of the payment of VAT to the supplier and the deduction of the input VAT.

Finally, some countries require taxpayers to submit payments on account. Under this system, a taxpayer has to make interim payments to the tax authorities computed based on its usual VAT liability in an average return. Taxpayers may identify distorting one-off sales that should be removed from the computation and identify any reduction in the taxpayer’s gross receipts that could lead to a reduction in the value of the interim payments.

Input VAT Optimization

Input VAT is generally deductible when the output VAT is due to the tax authorities. However, there are always delays between the tax point date on purchases made by a business and the time the input tax is claimed. Delays can occur for a variety of reasons, including backlogs in processing, the payment authorization system, or transfers between accounting departments. Taxpayers can improve their input VAT cash flow by identifying the input tax relating to the current VAT period, which has been excluded from the input tax reports used by the taxpayer to compile its VAT returns. This can happen in the case of an invoice issued by the vendor in the tax period that was only received and posted to the general ledger in the next tax period. By identifying these invoices and ensuring that the input VAT deduction is taken during the tax period in which the invoice was issued, taxpayers can ensure that the VAT deduction is taken as early as possible. Attention should be paid to the specific conditions to implement this process. In Australia, for instance, taxpayers can do this only if the invoice received after month close is dated in the correct month (being the preceding period).

Moreover, accounts payable processing often delays certain invoices for various purposes by “parking” them. As a result, the input VAT on a transaction does not hit the general ledger and is not deducted until the invoice is subsequently fully processed, even though it could be claimed as an input VAT credit in the month the invoice was received. Taxpayers may thus improve their cash flow by identifying parked invoices with an invoice date prior to the end of the VAT period, but which have not been posted to the VAT general ledger account on the day the VAT reports are run.

Taxpayers should further review their VAT deductions for travel and entertainment expenses incurred by employees for business purposes. While subject to some restrictions, depending on the type of expense incurred, the VAT charged on these expenses can often be recovered. However, businesses sometimes fail to not recover this VAT because their systems do not track the expenses or they are not aware of the particular requirements. This is often the case with marketing subsidiaries that typically recharge all of their expenses incurred in the course of providing their services (including customer entertainment / support costs, etc.) to their overseas principal on a cost-plus basis. These marketing subsidiaries will nonetheless block the recovery of VAT on any expense classified as customer entertainment or customer support, which can be substantial. While companies may currently not incur significant travel and entertainment expenses, they may, however, look back to VAT incurred in the past and file a refund claim with the tax authorities.

Finally, taxpayers who are doing business internationally may incur input VAT on purchases in countries where they are not established and are not registered for VAT. Some countries allow the input VAT incurred by these companies to be recovered, thus reducing the effective cost of purchases made abroad. For instance, in the EU, non-established taxpayers may recover input VAT incurred in an EU Member State. Taxpayers from an EU Member State can reclaim VAT in other EU Member States via an electronic refund procedure, while taxpayers not established in the EU may reclaim the input VAT directly in the Member State in which they incurred the tax. However, certain Member States may apply reciprocity rules so that refunds are only allowed if the taxpayer is established in specific countries. Foreign VAT recovery may also be optimized by filing more frequent refund claims. While refund claims are generally filed annually, it is possible under certain conditions to file more frequently.

Compliance Optimization

Effective use of the compliance rules can also help businesses optimize their VAT cash flow. The majority of countries require taxpayers to file either quarterly or monthly VAT returns. However, some countries allow taxpayers to request a change in the filing frequency from quarterly to monthly or from monthly to quarterly, especially when there is a substantial change in revenues. The purpose of the change to monthly returns is to assist taxpayers by speeding up the refund of excess input VAT. The purpose of quarterly returns is to assist taxpayers by slowing down the payment of VAT to the tax authorities. Taxpayers in a VAT payment position should ensure they are on quarterly returns where possible.

In some countries, the filing period to which a taxpayer is assigned is staggered instead of following the usual calendar quarter. For various reasons, such as financial year end, taxpayers may find that the return stagger assigned by the tax authorities causes administrative or accounting difficulties. To alleviate these difficulties, the tax authorities may agree to a request to change the return stagger if an appropriate reason is given.

VAT offsetting opportunities can also aid in maintaining cash flow. In some cases, a VAT refund due may be offset against other taxes due, most notably wage tax or corporate income taxes. In this manner, taxpayers save
an outlay for wage taxes (for example) and need not wait for a VAT refund to be secured from the tax authority. While these tax offsets do not provide a direct cash influx to companies, they are often processed faster and more often accepted than VAT refund claims. Another possibility is to offset output VAT that would be collected from a customer on a sale with the corresponding input VAT the customer would be able to deduct. Some countries allow this on a tailor-made basis for transactions in which there is in an exceptionally large amount of VAT due. The result of such an offset is that the vendor does not have to pay the VAT due, and the customer does not receive the corresponding VAT deduction. This also implies that the customer does not have to pay the VAT charged by the seller.

Finally, when there are fluctuations in global currencies, there may differences between the amount invoiced in one currency and later reported on a VAT return in another national currency. Jurisdictions provide guidance on the exchange rate to use for conversion, but often allow taxpayers to opt for the exchange rate applicable on either the day of the transaction, a specific day in the month in which the transaction occurred, or an average rate. Therefore, applying a different exchange rate may limit the impact the currency fluctuations have.

In South Africa, for instance, taxpayers may opt for one of the following exchange rates (published on the website of the South African Reserve Bank and other resources): (1) the daily exchange rate on the date sale occurs, (2) the daily exchange rate on the last day of the month preceding the sale, or (3) the monthly average rate for the month preceding the month during which the tax point occurs (i.e., the earlier of the issuance of an invoice or the receipt of payment). However, the last two options may not be used in exceptional circumstances that result in the South African rand value being distorted, which, among other things, include the collapse of a foreign currency.

**Cash Flow Transaction Optimization**

Multinational enterprises may be considering restructuring their supply chains for cash savings purposes or to address some of the logistical challenges brought by Covid-19. As a transaction tax, VAT affects each stage of a supply chain (from manufacturing to distribution through logistics, global sourcing, and shared services) where even a slight change in the nature and circumstances of an individual transaction may have a major impact on the VAT treatment and, if managed incorrectly, could create unexpected VAT costs (e.g., new compliance obligations, irrecoverable VAT, etc.). Therefore, VAT should be carefully considered when amending existing supply chains.

Beyond the restructuring of supply chains, taxpayers may also improve their cash flow by reviewing existing supply chains. Many countries offer some form of VAT grouping. A VAT group is considered a single VAT taxpayer, in which intra-group transactions are deemed non-existent for VAT purposes. As a result, a VAT group eliminates the need to pay VAT and then reclaim it on a subsequent transaction within the group. In addition, it reduces any non-recoverable input VAT for exempt taxpayers because intra-group transactions do not result in input VAT for the intra-group customer.

Cash flow improvements can also be accomplished in cross-border transactions. In many countries, if a taxpayer receives services from a seller established abroad, the taxpayer is liable to self-account for VAT in its VAT return. In VAT language, this is referred to the “reverse charge mechanism” because the liability to declare output VAT is reversed from the seller to the customer. As the customer can deduct input VAT on the transaction in the same tax period, the reverse charge mechanism often results in no net VAT payment if the taxpayer performs only taxable transactions. Consequently, purchasing services from abroad may simply eliminate a taxpayer’s cash-flow timing issues. This should, however, be carefully reviewed to avoid unwanted consequences such as the vendor charging foreign VAT on its services because the vendor country applies a limited concept of “exported services.”

Moreover, the importation of goods often triggers the payment of VAT at customs clearance by the importer of record. In most countries, the payment of VAT at the time of import may be avoided by using customs warehouses, free zones and various other customs relief measures. Transactions performed within these areas are generally not subject to VAT so that they will not affect the VAT cash flow. If such areas are not available or when the goods leave those areas, import VAT becomes due. Some countries allow taxpayers to defer the VAT due on imports. VAT deferral can either be a delay of import VAT payments (i.e., to a certain date in the month) or the application of a reverse charge mechanism for the import VAT due that results in no VAT payment for taxpayers performing only transactions allowing the taxpayer to recover VAT.

For taxpayers regularly exporting goods, some jurisdictions may allow regular exporters to purchase goods destined for export free of VAT. In Ireland, for instance, businesses, whose international sales exceed 75% of their total Irish turnover, can opt to have all their purchases, including imports, zero-rated for Irish VAT.

For taxpayers performing exempt activities, the input VAT often constitutes a final cost. For instance, this is the case in the financial industry or the real estate industry where most of the sales are VAT exempt. However, some countries allow taxpayers to opt for some of their exempt transactions to be taxable. For instance, in Luxembourg, taxpayers leasing immovable property may opt to have their lease subject to VAT, thus allowing the recovery of input VAT incurred in relation with this activity. These options are commonly subject to conditions, one of which is often that the customer (e.g., the tenant in the example above) is a taxpayer performing exclusively taxable transactions.

When businesses use promotional activities, the choice between vouchers and gift cards may result in cash flow savings. In most countries, the taxable transaction is either the sale of the voucher, or the redemption of the voucher. The latter would delay the point when VAT is due. However, this could also imply that issuing the voucher is an exempt or non-taxable transaction, reducing the potential that the input VAT might be recovered. Further, free vouchers issued when goods or services are sold to a customer may reduce the taxable value of the goods by the deemed value of the voucher, if the issuance of the voucher is regarded an exempt or non-taxable activity. The VAT treatment is complex and varies greatly based on the business model.
UNDERSTAND THE VAT TREATMENT APPLICABLE TO CERTAIN TRANSACTIONS/ISSUES

Cancellations, No-Show, and Penalties

As a result of Covid-19, it is likely that businesses have or will experience a significant volume of cancellations, no-shows, and other similar events, for which certain commission, administration, or other fee income is being earned. The VAT treatment of these transactions in many jurisdictions is contentious, and in certain countries it may not be necessary to account for indirect tax liabilities on these.

A cancellation fee is generally considered a penalty of sorts because the customer cancels a reservation after the allotted penalty free deadline. A no-show fee, on the other hand, would be applied in a situation in which the customer does not use a service or fails to contact the vendor to cancel the reservation. Both fees, while similar, are likely subject to different VAT treatments across the world.

In many EU Member States, cancellation fees will likely be considered outside the scope of VAT, while no-show fees will be subject to VAT. Such a distinction is largely based on EU case law, which established that any amount charged for cancellation is taxable only if there is a direct link between the service provided and the consideration received, the sums paid constituting the actual consideration for an identifiable service provided in the context of such a legal relationship. In this respect, no-show fees are often considered to be paid in consideration for the possibility of using a service. However, pure cancellation fees should be considered as compensation for the loss suffered as a result of the customer’s cancellation and should thus not be subject to VAT.

The same distinction may not apply all over the world. In Australia, for example, while pure compensation for damages should not be subject to GST, the Australian Tax Office might often consider no-shows and cancellation fees as consideration paid either for the initial sale or as different service (e.g., facilitation service, cancellation service, or release service) subject to its separate GST treatment.

Bad Debts

Businesses around the world will likely also experience customers not only delaying payments, but in a worst case becoming insolvent. Here again, businesses should not disregard the impact VAT may have on cash flow. As mentioned previously, because VAT is often prepaid to the tax authorities because of the tax point rules, when a debt becomes uncollectible the unpaid VAT becomes a cost to the company. Most countries allow a recovery of certain bad debts if correct procedures are followed. However, in certain countries, such as China, VAT on bad debt becomes an uncollectible cost for businesses.

A large number of countries allow taxpayers to recover output tax on unpaid invoices when a certain period of time has passed or when it is clear that the customer will definitely not pay. VAT bad debt regimes vary greatly across the globe and are often subject to very stringent conditions. For instance, the U.K. has implemented an almost automated bad debt relief mechanism whereby a bad debt is deemed to be uncollectible, and a right to a VAT refund arises, if the customer has not paid the consideration wholly or partially within six months. Under Bahrain’s new VAT law, on the other hand, the VAT bad debt relief is subject to several cumulative conditions: (1) the taxpayers must prove that they have taken all necessary steps to recover the debt (e.g., evidence of emails, calls, registered letters, notification for payment etc.) (the VAT General Guide states that the supplier must have initiated legal proceedings against the customer at the very least to recover the debt); (2) the debt must be written off in the records of the taxable person as a bad debt, in whole or in part; and (3) the debt must not have been collected for a period of 12 months or more, with the exception of non-payment due to bankruptcy.

As a consequence, many taxpayers do not apply for bad debt relief or do it too late. Given the various and rigorous conditions, taxpayers need to pay attention and make certain they have the required data.

Gifts and Donations

Companies may also provide goods and services free of charge to assist nonprofits, government entities, and even their own employees. In a few jurisdictions, free-of-charge supplies, whether as a gift to a third party or a donation to a nonprofit, does not have a VAT consequence. In Japan, free-of-charge supplies generally do not qualify as taxable events as long as these supplies do not impose any obligations upon the recipient. However, if a gift is given with the purpose of imposing upon the recipient a duty to perform some obligation, that gift is considered to be a transfer of assets subject to consumption tax.

Unfortunately, in the world of VAT, free-of-charge supplies often raise issues for tax authorities because the supplier is likely to have recovered the input VAT on purchase of the product or raw material that was used to make the product. Countries thus often require taxpayers either to correct the amount of input VAT originally deducted or to self-assess VAT on the free-of-charge supply.

In the U.K., for instance, the disposal by a taxpayer of goods forming part of the business’s assets free of charge, or their application for purposes other than those of his business, is treated as a sale of goods for VAT purposes, and therefore, subject to VAT on the deemed value (open market or cost value). This rule does not apply to business gifts of a value not exceeding GBP 50, unless the gifts are part of a series of gifts of total value exceeding GBP 50. However, if goods are donated for sale, hire or export by a charity, then the supply by the donor is also zero-rated. Croatia adopts a similar approach to the U.K., but also requires taxpayers to issue invoices. In the Netherlands, businesses making free-of-charge supplies must in principle adjust the input VAT originally deducted.

Some jurisdictions also distinguish between gifts to third parties and donations to nonprofits. For instance, Italy applies similar rules to the U.K. with respect to gifts. However, Italy will exempt donations of goods for which production is part of the typical activity of the company when they are provided to public bodies and nonprofits.
As these issues become more prevalent, tax authorities have started issuing special guidance relieving taxpayers from any VAT obligation for a Covid-19 related donation. For instance, the French tax authorities recently issued guidance clarifying that, given the emergency status, gifts of medical products (masks, hand sanitizers, protective clothes, and ventilators) made to care facilities (hospitals, nursing homes, physicians, etc.) or to public authorities (state or local authorities) do not give rise to a VAT adjustment. Companies must keep documentation proving the date, nature, value, and beneficiaries of gifts. This measure applies to gifts made during the Covid-19 health emergency period, the end of which is currently set at May 24, 2020 (subject to further extension).

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