TAX EXECUTIVES INSTITUTE, INC.

15 December 2014

Mr. Donato Raponi
European Commission
Directorate-General for Taxation and Customs Union
VAT and other turnover taxes – Unit C1
Rue Joseph II 79, Office J79 05/093
B-1049 Brussels

Via email: Donato.Raponi@ec.europa.eu

Subject: Proposal for VAT Rate Change Protocol

Dear Mr. Raponi,

Over the past decade, Member States have changed their VAT rates over 20 times – often with little notice. Implementing these frequent changes presents significant and costly challenges for businesses with operations in the Single Market. Those challenges are magnified when Member States do not provide timely notice of the rate changes or publication of the necessary transitional rules. The lack of any required notice period for VAT rate changes and the use of disparate transitional rules by Member States increases compliance costs for businesses and threatens the principle of neutrality, which is critical to a properly functioning international VAT system. TEI urges the Commission to develop a common protocol for VAT rate changes by Member States that would include, among other guidelines: minimum advance notice, common transitional rules, and alignment between effective dates and established VAT reporting periods.

Tax Executives Institute (TEI) was founded in 1944 to serve the needs of business tax professionals. Today, the organization has 56 chapters in Europe, North and South America, and Asia. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting tax policy, as well as the fair and efficient administration of the tax laws, at all levels of government. Our nearly 7,000 members represent over 3,000 of the largest companies in the world.

TEI members are accountants, lawyers, and other corporate and business employees responsible for the tax affairs of their employers in an executive, administrative, or managerial capacity. The Institute espouses organizational values and goals that include integrity, effectiveness and efficiency, and dedication to improving the tax system for the benefit of taxpayers and tax administrators alike.

Many TEI members work for large multinational businesses that operate in corporate groups with numerous VAT registration numbers in multiple countries. These businesses generate large volumes of transactions with third parties and related parties (intercompany transactions) that are managed by large Enterprise Resource Planning (ERP) information systems. The businesses generally (i) are audited by external accounting firms, (ii) possess strong internal controls in order to satisfy regulatory and legal requirements (such as the Sarbanes-Oxley Act in the United States or the Senior Accounting Officer measure in the United Kingdom), and (iii) have a senior finance executive with oversight responsibility for financial, management, regulatory, and tax reporting. The education, training, and experience of our members enable them to bring a balanced perspective on the issues raised in this letter.

I. The Complex VAT Rate Change Implementation Process

Implementing VAT rate changes[1] is a costly, complex, and cross-functional exercise for businesses operating in the EU. Each time a Member State makes a change to its VAT rate, businesses operating in that Member State must analyze the change, implement and test information systems changes, and communicate pricing changes to personnel throughout the organisation (and the resulting effects of those pricing changes). All of these actions require sufficient lead-time to accomplish effectively.

A. Identification and Legal Analysis

Before a VAT rate change can be implemented, businesses must identify and analyse the change. This can be more difficult than it sounds. Lack of access to timely information about the legislative or administrative processes in Member States often obscures the change in law or procedure. For businesses operating in several Member States, lack of access to accurate legal translations also hinders these efforts. Businesses regularly employ external professional advisors and local contacts for assistance, especially in providing timely alerts about potential changes.

Once it becomes clear that a rate change will occur, businesses must analyse the details of the change and any transitional rules that will affect its application to current and future transactions. The outcome of this legal analysis provides the foundation and parameters for designing the business and systems implementation plan. In this respect, TEI applauds and supports the Commission's Web Portal initiative to create a single, on-line repository for VAT guidance from all Member States.

B. Changes to IT and Non-Automated Systems

Unfortunately, there is no "easy button" businesses can press to update their complex ERP infrastructures for VAT rate changes. Those programming and process alterations require significant time to identify, revise, and test. For various business reasons, including acquisitions and mergers, large multinational businesses often utilize multiple ERP systems, comprised of home-built systems, bolt-ons, or some combination of the two. No matter the

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[1] References to VAT rate changes in this letter include both (1) increases and decreases in standard or reduced VAT rates; and (2) shifting of goods and services from standard to reduced rates (or vice versa).

[2] Japan recently recognized these negative practical effects of consumption tax rate changes in April 2014 and

number and types of systems used, VAT rate changes affect several areas of the IT landscape, such as Master Data, Financial Modules, Purchase Modules, and Sales Modules. Each of these areas may be used by different departments within the business, which increases the number of internal stakeholders affected by the VAT rate change and expands the coordination necessary for the implementation to be successful.

VAT codes provide an example of the granularity of these system changes and the extent to which they affect business processes. These codes electronically label transactions to facilitate automation of their associated VAT treatment. When a VAT rate is changed, additional codes must often be created to address the application of transitional rules or retrospective cancelations of transactions entered into prior to the effective date of the change. Established ERP systems do not necessarily support the generation of these additional codes, requiring the purchase and installation of additional software.

These IT challenges extend beyond hardware and software. Most in-house tax departments do not have dedicated IT staff and rely instead on a general IT department, which must prioritise systems change requests with other company IT initiatives. When internal resources are not available, businesses must engage external specialists. Use of internal and external IT expertise comes at a cost. While some IT budgets leave room for unexpected events, obtaining the necessary approvals and managing other cost constraints increases the lead time for securing the resources to implement the required systems changes.

All changes made to ERP and other business software systems must be tested and monitored to ensure compliance with the VAT rate change requirements without interrupting existing businesses processes. This includes testing by multiple stakeholder groups throughout a business. VAT rate changes also require training and testing for non-automated procedures, such as accounts payable data entry, marketing and sales plans, and budgeting and planning functions driven by pricing decisions for affected products and services. Organising and managing review by these diverse groups takes a great deal of coordination and scheduling. It also adversely affects productivity because workers are diverted from their normal duties to participate in software testing and validation.

Businesses make large investments of time and capital to comply with VAT rate changes. Frequent VAT rate changes with unreasonably short timelines for implementation unduly burden businesses that are essentially collecting VAT on behalf of Member State governments. While the implementation process can take well over a month to complete, changes to VAT rates have occurred with as little as a week of advance notice, making immediate and full compliance incredibly difficult, if not impossible.

C. The Effect of VAT Rate Changes on Pricing

The effects of VAT rate changes cascade throughout a business, altering the pricing of goods and services and creating complex (and costly) information technology systems challenges. Because prices for sales to final consumers are communicated with VAT included, a change in rate forces retail businesses to revise the prices on potentially thousands of items throughout their stores and accounting systems. With little or no advance notice of a VAT rate change, businesses that have engaged in marketing campaigns promising certain pricing for their products and services must absorb the change through reduced margins.

Forcing businesses to bear the burden of the VAT in this manner erodes the principle of neutrality.[2]

VAT rate changes also affect business-to-business transactions. Some business customers cannot deduct all input VAT and, as a result, generally request a renegotiation of the prices in contracts concluded prior to a rate change. These discussions divert the attention of operational and legal personnel within companies and can affect margins and even cause purchasers to revise their orders. Lower margins or reduced orders create ripple effects in areas such as budgeting and planning where forecasts may need to be revised to take these changes into account.

II. Recent Experience with VAT Rate Changes

Over the past decade, many rate changes in the EU have been enacted with little advance notice.

A. Examples of Short Notice Periods

- **United Kingdom (2008)** – Temporary rate reduction announced on 24 November 2008 that went into effect 7 days later.
- **Romania (2010)** – Standard VAT rate increase announced on 25 June 2010 that went into effect 6 days later.
- **Italy (2011)** – Standard VAT rate increase announced in June. This decision was not finalized until 6 September 2011 with an effective date set for 11 days later.
- **Hungary (2011)** – Authorities announced plans to increase the standard VAT rate in September, but did not confirm the rate change would take place until 21 November 2011 with an effective date of 1 January 2012.
- **Czech Republic (2012)** – In December 2012, after considering the introduction of a uniform 17% VAT rate, the Czech government decided to temporarily increase both the reduced and standard VAT rates by 1%. This decision became official on 21 December 2012, only 11 days before the effective date (1 January 2013). In view of Christmas-related bank holidays, taxpayers were effectively allowed only 5 working days to implement the change.
- **Italy (2013)** – The government announced a planned increase to the standard VAT rate scheduled to take effect on 1 July 2013. This change was delayed until 1 October 2013 and discussions about a further delay continued. During the week before the delayed effective date, some advisors issued alerts predicting that it was almost certain the rate increase would be delayed until 1 January 2014. On Monday, 30 September 2013, after a weekend of political turmoil, it became clear that no further delay had been passed and that the increase would become effective the following day – Tuesday, 1 October 2014.
- **Croatia (2013)** – The government unexpectedly accelerated its plans to increase the reduced VAT rate. These changes were published in the Official Gazette on 11 December 2013 and took effect 8 days later.

[2] Japan recently recognized these negative practical effects of consumption tax rate changes in April 2014 and permitted retailers to communicate their prices exclusive of VAT through the end of March 2017.

B. Consequences of Short VAT Change Notice Periods

Businesses and governments are partners in a properly functioning VAT system where businesses act as tax collectors on behalf of the Member States. Unacceptably short VAT rate change notice periods erode certain foundational principles relied upon by all stakeholders in that system. For example, the principle of neutrality requires that VAT is borne by the final consumer, rather than any of the intermediaries in the supply chain. This principle is codified at Title X of the VAT Directive and also serves as an international norm for VAT (*e.g.*, the OECD's International VAT/GST Neutrality Guidelines, which were approved by the Committee on Fiscal Affairs of the OECD in July 2011). The principle of neutrality is also critical to the proper functioning of the Internal Market. Forcing businesses to absorb VAT rate increases by reducing their margins as a result of inadequate advance notice violates the principle of neutrality.

At the same time, lack of sufficient notice for VAT rate increases runs counter to the principle of legal certainty. Those affected by laws and regulations ought to have the ability to ascertain their obligations under those rules. As the European Court of Justice has observed, the "requirement of legal certainty must be observed all the more strictly in the case of measures liable to have financial consequences in order that those concerned may know precisely the extent of the obligations which it imposes on them."[3] When businesses have only a few days to fully analyze and implement VAT rate changes, it does not permit enough time to adequately adjust systems and procedures in a way that avoids significant compliance risks. This also deprives Member State revenue authorities of the tools they need to apply the law in audits and in providing guidance to stakeholders.

III. Proposal for EU VAT Rate Change Protocol

Member States must certainly be afforded the freedom to address their revenue needs within the parameters established by EU law. Each Member State has its own unique challenges and its own market considerations. Nevertheless, all stakeholders in the EU's VAT system would benefit from increased structure around VAT rate changes. TEI urges the Commission to consider establishing a protocol or framework for VAT rate changes and suggests the following areas be included in that framework:

- **Minimum Notice Period** – The time required for taxpayers to implement a VAT rate change depends on the size, complexity, scope, and diversity of the business. The complexity of each company's IT infrastructure also affects its ability to adjust quickly. TEI suggests a minimum notice period of two months for a VAT rate change to accommodate the majority of businesses. This is in line with the experience of TEI members and the findings of other studies.[4]
- **Alignment with VAT Reporting Periods** – Implementing a VAT rate change in the middle of a reporting period creates additional challenges and makes auditing VAT returns more difficult for tax administrations. A protocol addressing VAT rate

[3] *Opel Austria v. Council* [1997] ECR II-39 Case T-115/94 at para. 124.

[4] HMRC Compliance Costs and Commercial Impact of December 2008 VAT Rate Change (October 2010), page 101, *available at* www.hmrc.gov.uk/research/comp-costs-comm.pdf (last accessed 29 September 2014).

changes would better serve all stakeholders if it required all VAT rate changes to occur at the beginning of a reporting period.

- **Harmonised Transitional Rules** – The rules governing transitions from one rate to another vary widely among Member States. These rules significantly affect transactions that straddle a VAT rate change effective date. A single set of transitional rules would greatly benefit businesses and revenue authorities and promote legal certainty.
- **Transparency** – TEI strongly supports the creation of a web portal that would provide a repository for current VAT rules of the Member States and commends the Commission for its efforts to create such a tool. Guidance on VAT rate changes is a key part of this tool. Each Member State has unique procedures (*e.g.*, legislative, regulatory) that must be followed before a VAT rate change becomes final and effective. The web portal should include a way for taxpayers to see the status of VAT rate changes within the relevant Member State procedures to allow businesses to be more proactive in implementing those changes. Providing this guidance in a centralised location would give businesses the information necessary to comply and timely pay VAT to the Member States.

TEI believes these measures would reduce the costs and burdens associated with implementing VAT rate changes in the EU. At the same time, they would strengthen the fundamental principles of neutrality and legal certainty that serve as the basis for the EU VAT system. TEI stands ready to support the Commission and Member States in their discussions of the content and functionality of an EU VAT rate change protocol.

TEI's comments were prepared by the Institute's European Indirect Tax Committee, whose chair is Jean-Francois Turgeon. If you have any questions about TEI's comments, please contact Mr. Turgeon at +41 228 494 342 or Turgeon_Jean-Francois@cat.com, or Daniel B. De Jong of the Institute's legal staff at +1 202 638 5601 or ddejong@tei.org.

Respectfully submitted,
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