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VAT error could wipe out company's annual profit

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Many companies devote far too little attention to indirect taxation, such as VAT. The consequences of this neglect can sometimes be dramatic. Erroneous VAT calculations can wipe out a company's annual profit, or have consequences far beyond that.

The problem can often be traced to operational weaknesses: less-than-adequate internal systems that fail to properly process and display the VAT consequences of business transactions. At a large multinational, a software error resulted in the company paying too much VAT over an 11-year period. The software registered when a customer was repaid the remaining portion of his subscription following its cancellation. What the system did not register was that the customer also received a VAT refund over the remaining portion. The total amount of wrongfully paid VAT eventually rose to around € 55 million, of which the tax authorities were only prepared to return € 20 million.

In the case of another company, a software error resulted in the opposite situation: it had deducted € 40 million in excessive input VAT.

Many organisations lack an 'indirect tax control framework' for defining a strategy, systems and control mechanisms to manage risks linked to reporting VAT. With an indirect tax control framework, companies determine the management level that is responsible for the entire VAT reporting process, from beginning to end.

The risk that VAT errors will compromise companies' financial positions and reputations is a growing one. With globalisation of business, the complexity of transactions in terms of VAT is increasing. The root of an operational VAT problem often lies in the inadequate modification of an IT system following a takeover or merger, international expansion or a change in the VAT qualification of transactions, as can happen when tax legislation is amended or a country joins the EU.

An indirect tax control framework minimises risks and reduces costs by improving operations. Take, for example, the computerisation of VAT calculations and reports and driving back the required VAT operating capital. A company with a good framework is in an excellent position to enter into an advance agreement with the tax authorities. The advantage of such an agreement is that companies gain speedier insight into their tax positions and that more emphasis is placed on monitoring the actual VAT position, rather than on subsequent verification.

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