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Top 10 signs that your SAP system can't manage EU VAT Complexity

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INTRODUCTION

More and more multinational businesses have European operations with complex cross-border flows and multiple foreign VAT registrations. However, SAP is often unable to handle the complex VAT rules and associated reporting requirements faced by such businesses.

Increasingly, we see tax and finance staff experiencing the following types of issues:

• Significant man-hours devoted to checking and validating transactional data.

• The need to develop, execute and maintain **bespoke reports** either to correct errors or format VAT-return data according to each tax authority's requirements.

• VAT **compliance** risk associated with errors, omissions and disclosure discrepancies stemming from underlying SAP transactional data.

From an IT perspective, the view may be different (but part of the same underlying root causes):

• Significant cost and resource-impact to main tain and support the VAT configuration in the face of constant business and legal change.

• **Limited internal skills and knowledge** to understand and implement correct VAT logic due to the complexity and constant change of the underlying business and legal requirements.

• **Loss of continuity,** as developments and change-requests are implemented over many years by teams who either no longer work for the company, or belong to external SAP maintenance partners.

Preventing the above impacts are crucial to supporting efficient VAT compliance and low-cost maintenance in your business. One issue we find is that many organisations don't recognise the signs early enough to take preventative measures.

Based on our extensive experience of reviewing our clients' SAP systems across all industries and markets, we have identified the top 10 signs that indicate that your SAP system cannot handle your EU VAT requirements in a compliant and efficient manner.

01: YOUR CONDITION RECORDS DON'T MAKE SENSE

Many businesses know that standard SAP cannot determine the VAT treatment for many types of complex EU transactions in an automated and compliant way. The root cause is that SAP doesn't know all the complex EU VAT rules. It is always left up to the business to "teach" SAP what the rules are.

To mitigate this, businesses often develop bespoke access sequences together with a complex set of condition records in order to try and derive a complex VAT decision. Whilst this approach can work for specific scenarios, it usually falters as new scenarios arise either when the business changes, or new VAT rules are introduced.

This may lead to further **patchwork developments** which create even more complexity. Over the years, such an approach can create a **highly complex** and **customised** VAT logic that no-one is able to understand, trust or maintain.

As a general rule, if you see that your business has set up:

- More than 5 access sequence steps (in total); or has
- Over 100 condition records (per VAT jurisdiction)

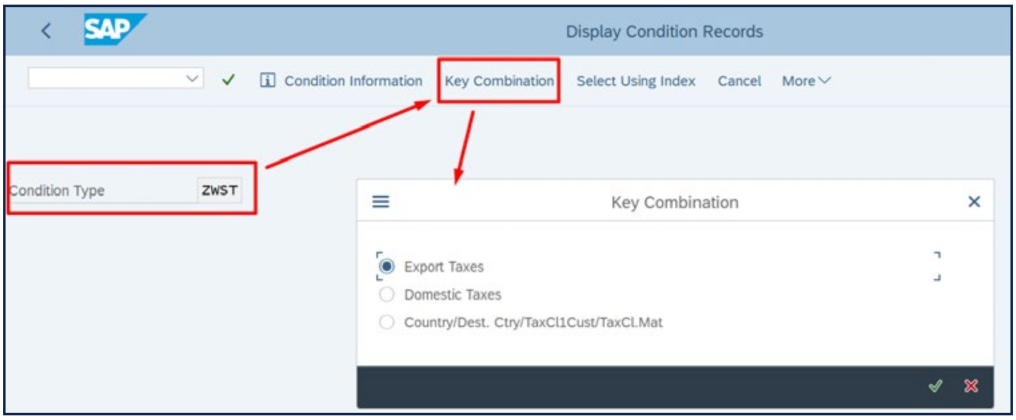
Then this is usually a clear indication that something is not right.

QUICK TIP: Here is what you can do to see how many access sequences you have and how to print out your condition records.

NO 01: YOUR INVOICE PRINTING PROCESS CONTAINS ITS OWN LOGIC

STEP 01

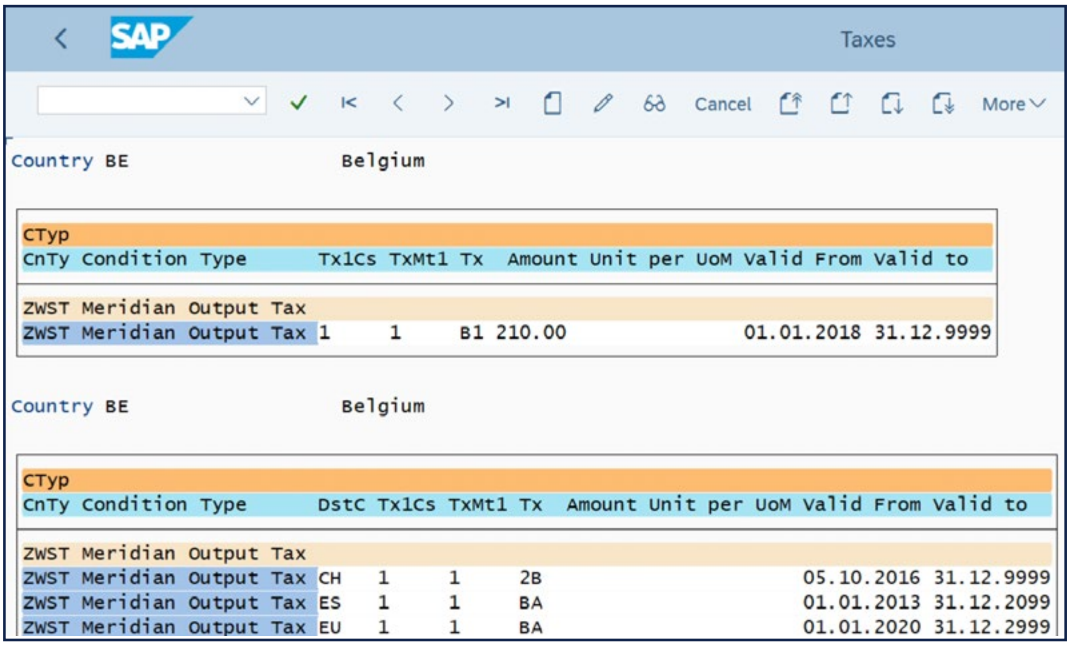
Use transaction 'VK13' to display the number of access sequence steps as set-up for the 'tax condition type' as used within your organisation:



* Every key-combination is 1 access sequence step

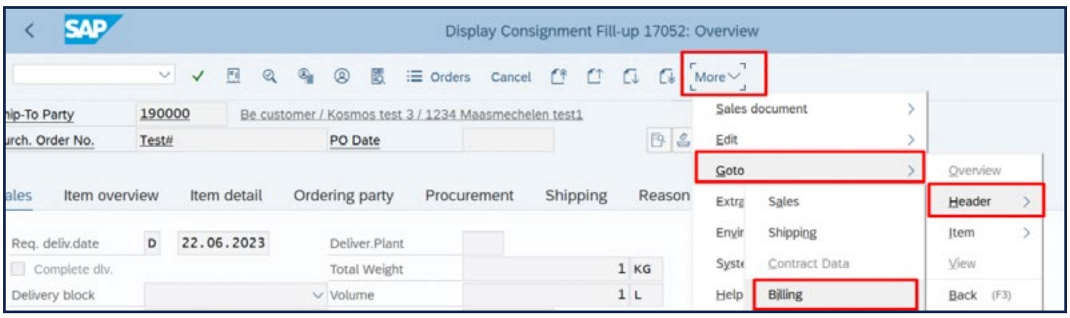
STEP 02

Use transaction "V/LD" to print-out the condition records including tax codes and tax percentage. If only the standard SAP access-sequence steps are maintained, pricelist '14' can be used in transaction "V/LD". However, if you have defined your own access-sequence steps, then the pricelist to be used needs to be customized by your SAP-SD consultant.



STEP 03

Review your access sequence steps and your condition records. Do they all make sense? Are there any records that you don't understand or don't seem right? If something doesn't seem right to you, then it probably is not and should be investigated.



NO 02: YOUR CUSTOMER SERVICES (ORDER MANAGEMENT TEAM MANUALLY CHANGE THE VAT CHARACTERISTICS OF SALES ORDERS

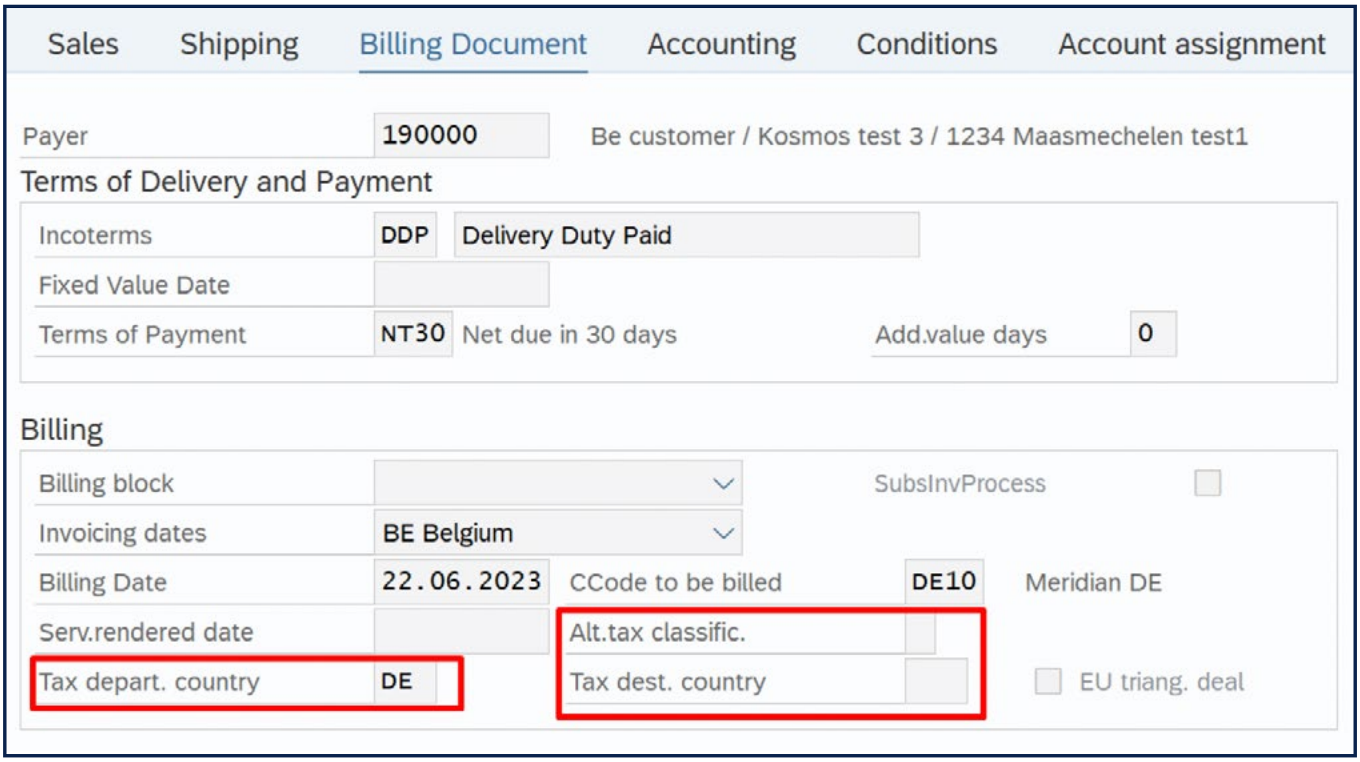
Standard SAP determines a VAT decision using 5 basic VAT determination characteristics:

1) Tax departure country **2)** Tax destination country **3)** Customer tax classification

4) Material tax classification **5)** Customer VAT ID number (in the case of EU transactions)

It is possible to manually change any of the above characteristics (with the exception of the customer VAT ID) whilst entering a sales order. This could be done to attempt to overcome a known limitation within SAP VAT determination and to try and force the correct the VAT result.

The following figure demonstrates where in a sales order, your Customer Services teams may manually change tax sensitive fields:



Customer Services teams usually tamper with these fields, in order to intentionally manipulate a tax result. This is usually done because the SAP system is not trusted to derive the correct tax treatment automatically. Whatever the circumstances, where such changes are allowed it means your company is allowing your non-tax staff to make decisions - which is very high risk. Where a business sees a large number of manual changes (including a large number of cancellations to correct billing documents) it will be very difficult to demonstrate to tax authorities that sales are dealt within in a compliant and systemic manner. As a result, the best approach is to aim for fully automated VAT determination without the possibility of manual changes by non-tax experts.

QUICK TIP: Here is a quick tip on how you can run a control report that will show exactly what manual changes were made to tax relevant fields in a sales order.

VAT determination in sales orders can be manually influenced by users tampering with the following header-values of the sales order:

- Tax departure country (Field->VBAK->LANDTX)
- Tax destination country (Field->VBAK-STCEG_L)
- Alternative Tax Classification (Field->VBAK-TAXK1)
- EU Triangular Deal (Field->VBAK-XEGDR)

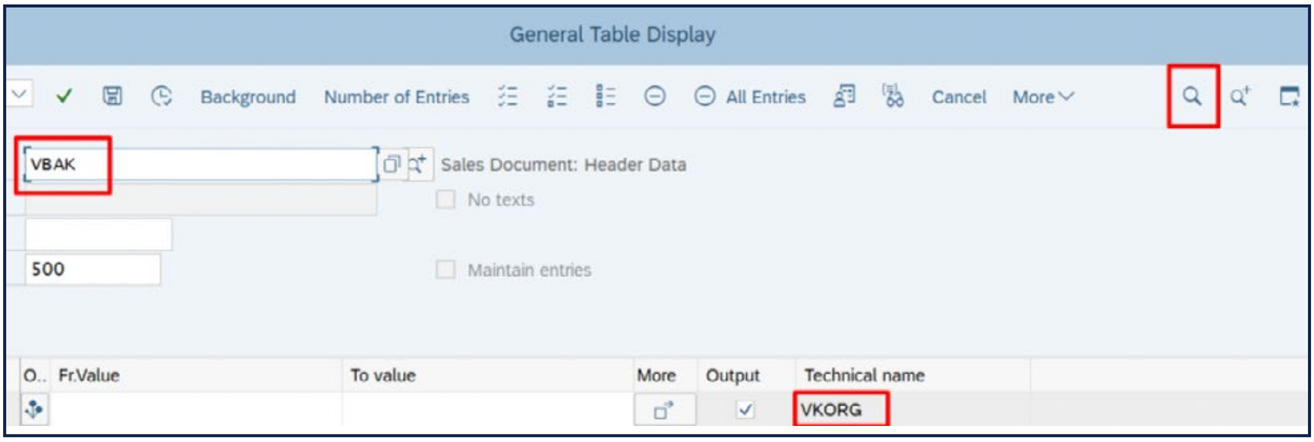
NO 02: YOUR CUSTOMER SERVICES (ORDER MANAGEMENT TEAM MANUALLY CHANGE THE VAT CHARACTERISTICS OF SALES ORDERS

STEP 01

To check if any of the above fields have been impacted during the creation of a sales order, ask your SAP team to execute the following extract via “SE16” or “SE16N”

A Run transaction SE16N and enter Table “VBAK”

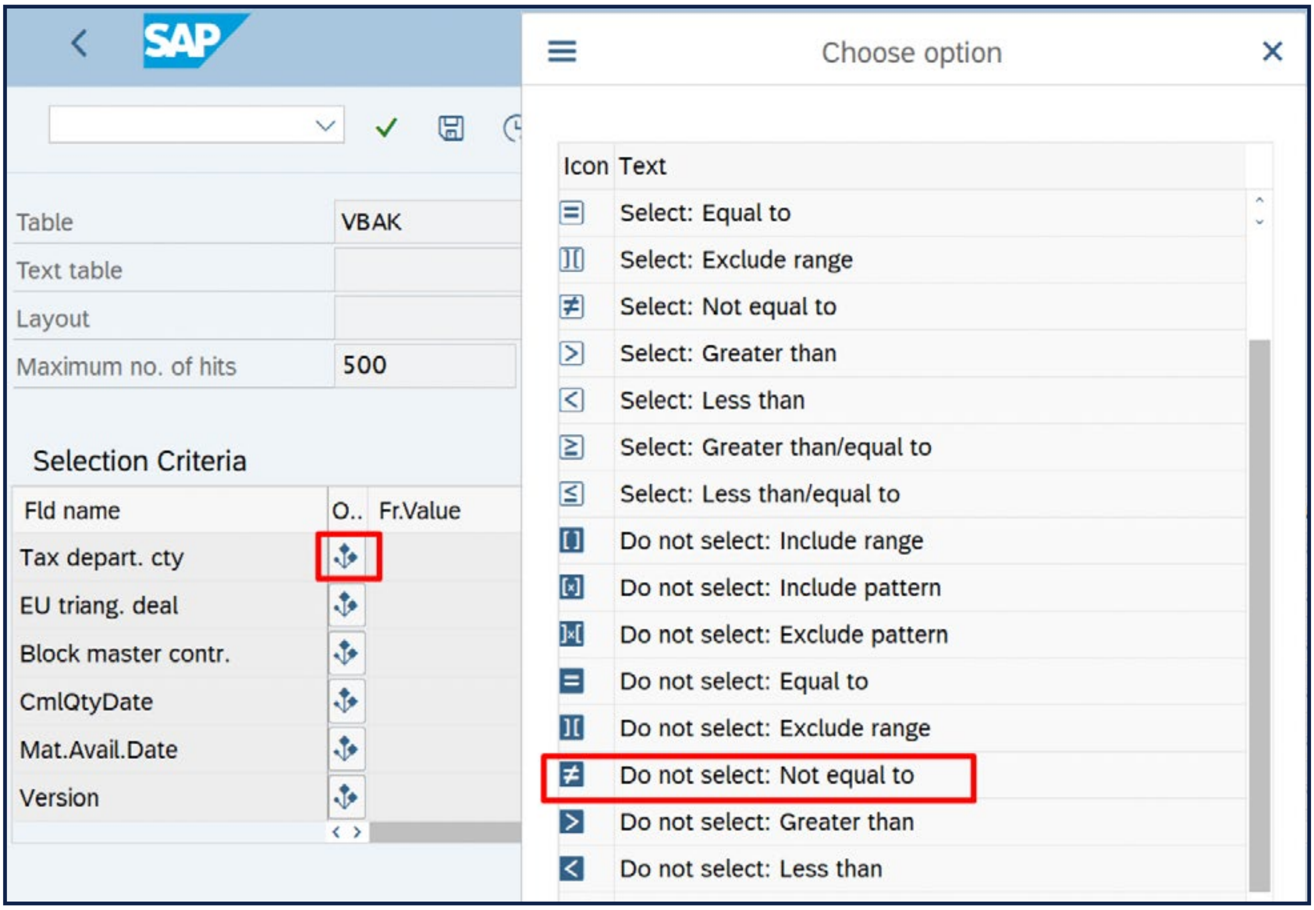
B Press “find” button (as shown below), enter “VKORG” and capture the sales organisation(s) that you want to query



C Press the “find” button again, enter creation date (Field->VBAK->ERDAT) i.e. the period range that you want to query”

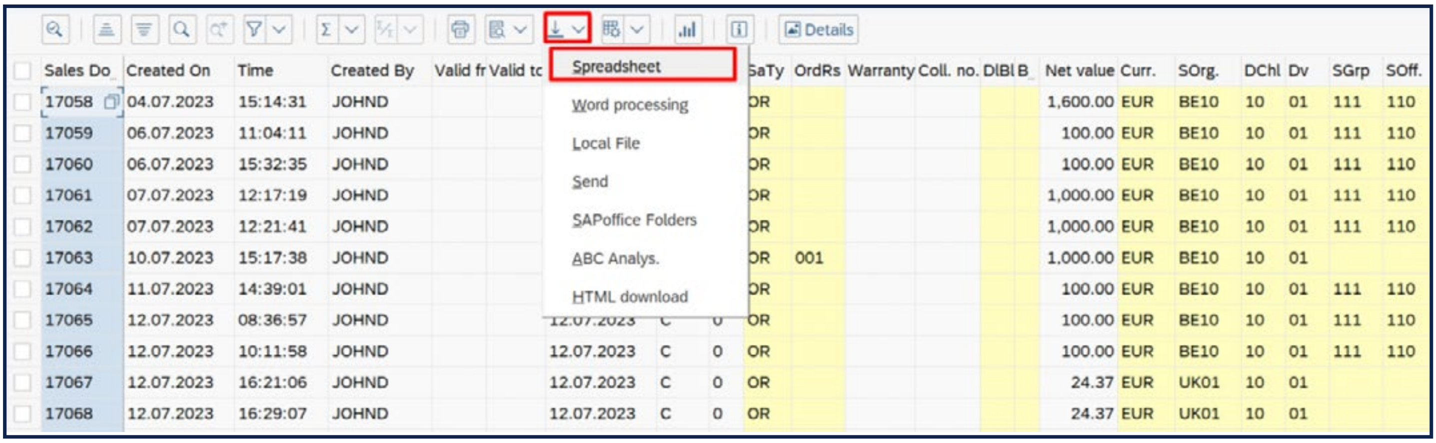
D Next enter “find” button, enter the “Tax depart. Cty” (Field->VBAK->LANDTX)

E Press “option” button (as shown below), select option “Do not select: Not equal to” and leave field blank i.e. query will pick up any changes recorded against this field



NO 02: YOUR CUSTOMER SERVICES (ORDER MANAGEMENT TEAM MANUALLY CHANGE THE VAT CHARACTERISTICS OF SALES ORDERS

F Execute query (F8) and then export data to excel (as shown below)



Sales Do	Created On	Time	Created By	Valid fr	Valid to				SaTy	OrdRs	Warranty	Coll. no.	DlBl	B	Net value	Curr.	SOrg.	DChl	Dv	SGrp	SOff.
17058	04.07.2023	15:14:31	JOHND						OR						1,600.00	EUR	BE10	10	01	111	110
17059	06.07.2023	11:04:11	JOHND						OR						100.00	EUR	BE10	10	01	111	110
17060	06.07.2023	15:32:35	JOHND						OR						100.00	EUR	BE10	10	01	111	110
17061	07.07.2023	12:17:19	JOHND						OR						1,000.00	EUR	BE10	10	01	111	110
17062	07.07.2023	12:21:41	JOHND						OR						1,000.00	EUR	BE10	10	01	111	110
17063	10.07.2023	15:17:38	JOHND						OR	001					1,000.00	EUR	BE10	10	01		
17064	11.07.2023	14:39:01	JOHND						OR						100.00	EUR	BE10	10	01	111	110
17065	12.07.2023	08:36:57	JOHND			12.07.2023	C	0	OR						100.00	EUR	BE10	10	01	111	110
17066	12.07.2023	10:11:58	JOHND			12.07.2023	C	0	OR						100.00	EUR	BE10	10	01	111	110
17067	12.07.2023	16:21:06	JOHND			12.07.2023	C	0	OR						24.37	EUR	UK01	10	01		
17068	12.07.2023	16:29:07	JOHND			12.07.2023	C	0	OR						24.37	EUR	UK01	10	01		

STEP 02

Repeat steps (d) – (f) for fields tax destination country, alternative tax classificationand EU Triangular deal as stated above.

NO 03: YOU MANUALLY POST CROSS-BORDER MOVEMENTS OF YOUR OWN GOODS

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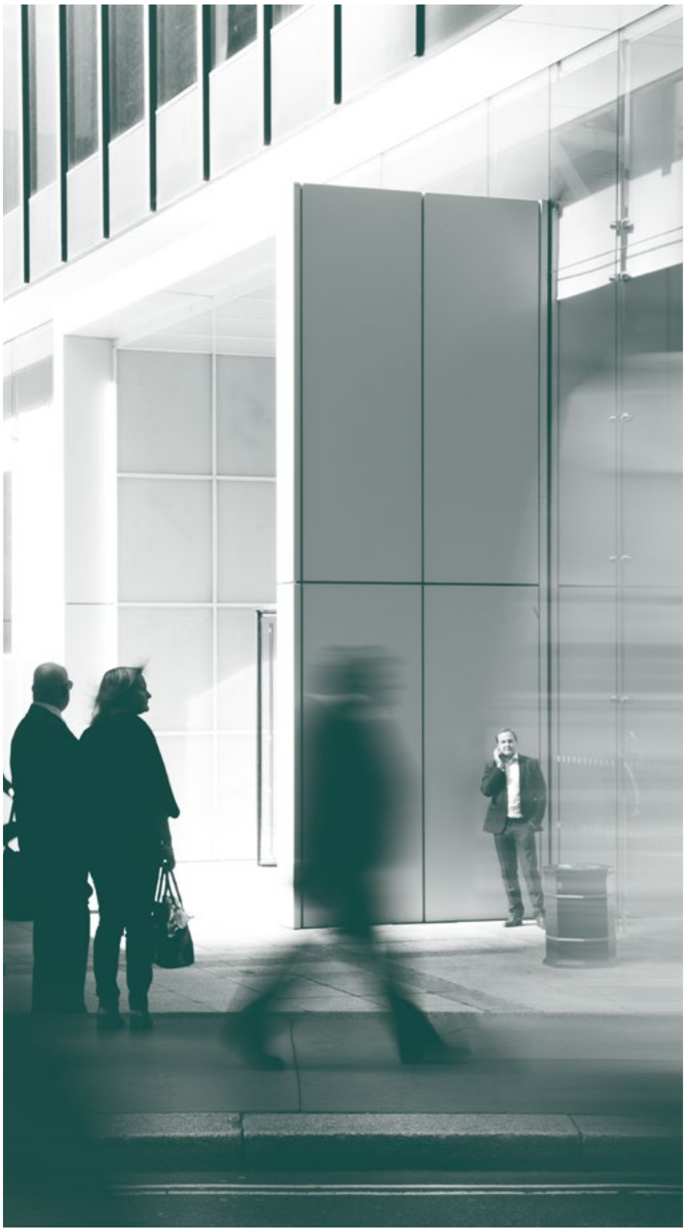
A common issue for businesses with multiple VAT registrations across Europe is the **movement of own goods** from one EU member state to another. From a VAT point of view, this requires specific reporting in VAT returns, EC Sales Lists and Intrastat declarations.

However, as movements of own goods do not result in financial postings, many businesses simply do not invest in the correct processes to automate all the VAT and Intrastat postings. They are then forced to **manually track** such flows in order to correctly include within their VAT declarations.

Such manual work is not necessary as SAP has developed standard **'Plants Abroad' functionality** to automate these cross border flows of own goods. By **implementing** this functionality, businesses can ensure that SAP correctly and automatically creates all the required VAT and Intrastat posting.

QUICK TIP: Learn about Plants Abroad and how to activate this functionality in our Webinar titled: 'Plants Abroad in SAP: Customizing, transactions and reporting': click here

ADVANCE TIP: You can also learn to activate this functionality for plants abroad in Non-EU countries by clicking here



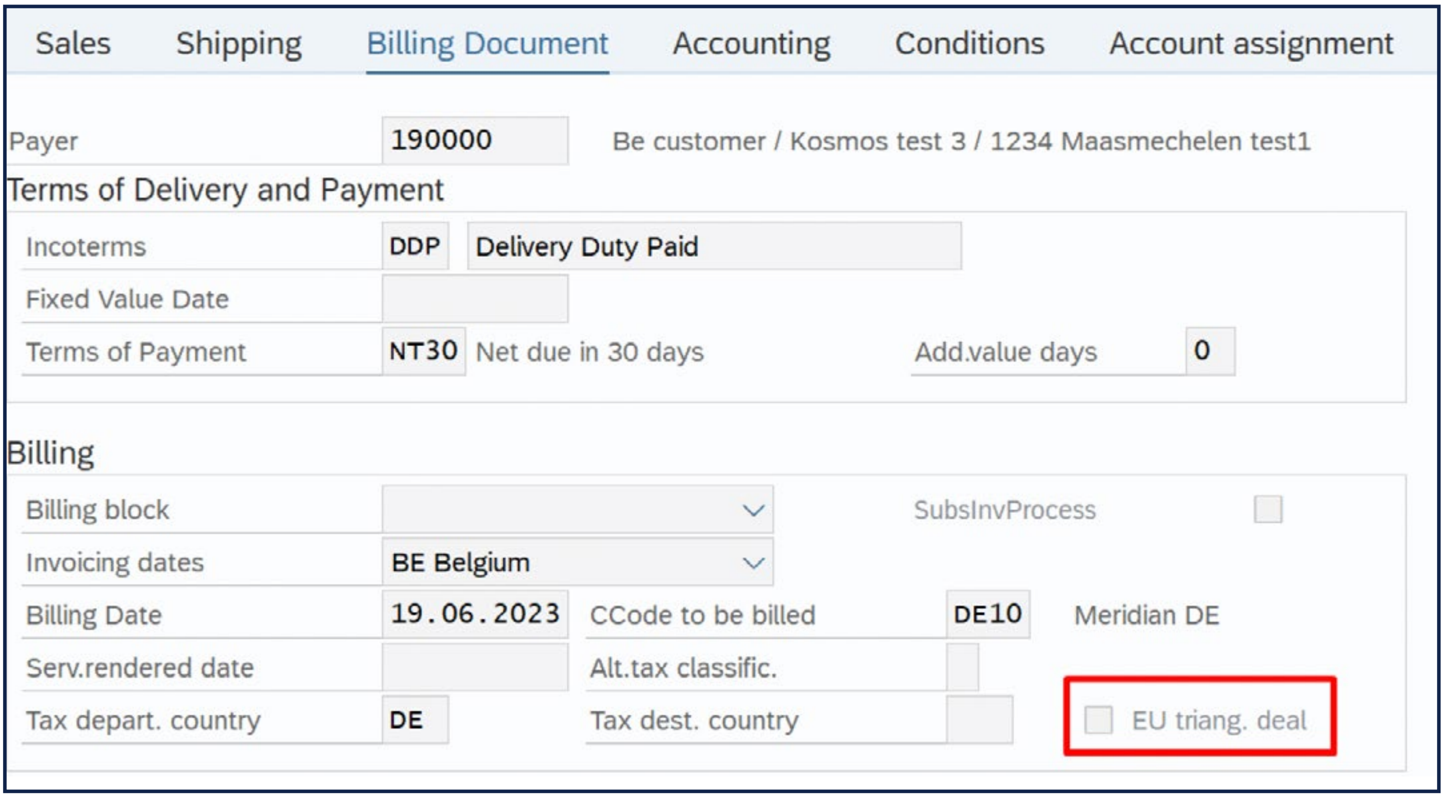
NO 04: YOU CAN'T AUTOMATE TRIANGULATION FLOWS

Many businesses will be involved in three party transaction chains which qualify for the **EU triangulation simplification.**

Standard SAP has only **limited functionality** within this area. However, it is entirely reliant on a manual tick during the sales order process.

Triangulation is one of the most complex areas in VAT. Businesses with multiple VAT registrations may be VAT registered in the country of destination and some EU countries don't allow use of the simplification in such scenarios. As such **ensuring staff correctly recognise** when triangulation applies is a huge challenge.

This figure shows the box that the Customer Services staff have to tick, in order to identify that this is Party "B" in a triangulation flow.



If you rely on this manual check, or perhaps you avoid triangulation in the fear that your SAP system will not be able to cope with the VAT treatment, then this is a clear point of failure in your set-up.

NO 05: UR INVOICE PRINTING PROCESS CONTAINS ITS OWN LOGIC

This can be a VAT manager's nightmare, as this conceals reality and presents a 'perfect picture', to mask non compliance.

Where SAP incorrectly handles VAT determination, there is the possibility of using **printing logic** to effectively correct the VAT treatment on a billing document. This can ensure that the outgoing invoice appears compliant from a VAT point of view and correctly reports the customer's VAT number and any relevant exemption texts.

However, such an approach will create **discrepancies** between your VAT invoices sent to customers, and how VAT is reported in the system.

This creates a significant downstream impact when it comes to preparing VAT returns, ECSLs, and Intrastat declarations given that the standard SAP reports will not be in line with the actual invoices sent to customers.

QUICK TIP: To check whether you have logic in your print program that overrides what is being determined in your SAP transaction ask your SAP SD consultant or a Developer to assist. In particular you will need to ask them to explain what logic is used within the print program to determine:

- The VAT registration number of your customer that is identified on the invoice

- Which customer's name and address (i.e. which partner role within the sales transaction) is printed

- How the correct exemption text is determined and so on

If there is logic built into these fields, then this is red flag that requires attention.

NO 06: UR INVOICE PRINTING PROCESS CONTAINS ITS OWN LOGIC

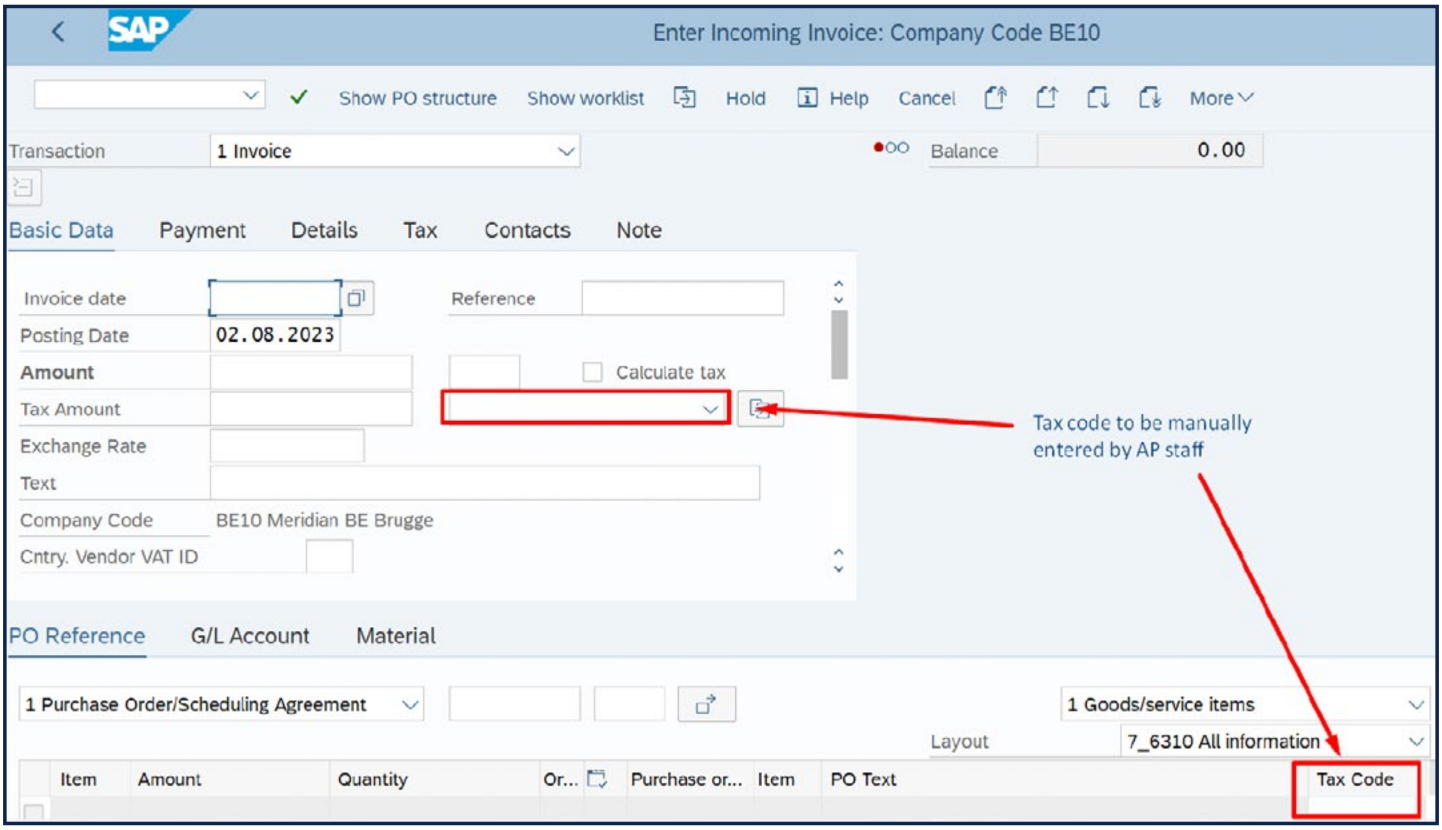
A common challenge for businesses is how to correctly determine the VAT on incoming invoices.

Where AP staff are responsible for selecting a VAT code on a purchase invoice, the business is effectively reliant on AP staff to be tax experts. To mitigate this risk, tax and finance departments will often provide guides / manuals and training to help facilitate accurate VAT code determination.

In practice, this will be hampered by a number of challenges:

- The **complexity** of VAT rules in this area particularly where it pertains to reverse charges and acquisition VAT reporting
- **Turnover of staff** in AP functions which themselves can often be located in another country
- **Performance** of the AP function being judged primarily on quantity of invoices processed and not accuracy of VAT coding

The figure below demonstrates how an AP clerk will need to select a tax code when entering an AP invoice



Due to the above, tax departments often find that time invested in training and providing guidance to AP staff is not productive. It is often the case that the tax department has to spend further time **reviewing and correcting** the VAT coding on invoices applied by AP staff. To read more on how you can automate the selection of tax code on AP invoices, click here

NO 07: YOU SPEND SIGNIFICANT TIME MANUALLY PREPARING YOUR VAT RETURNS

Many businesses are forced to carry out significant **manual work** outside of their system in order to compile their VAT declarations.

Typically, doing such work in **Excel** or in some cases within a bespoke database or **reporting** engine, this yet another symptom of underlying issues caused by inaccurate VAT determination in SAP.

Although practical when done on a small scale, such a manual approach is often **not scalable** for tax and finance teams responsible for multiple jurisdictions and VAT registrations.

Below is a small excerpt of a standard SAP VAT report (RFUMSV00) imported in MS Excel. When opening this report, it is apparent that:

- It is not 'user friendly'
- Many columns and rows are left blank
- Data is not formatted correctly, etc...

NO 08: YOU HAVE TO MANUALLY MANAGE FX RATES

When operating across Europe, businesses can often be reporting/ invoicing in two or three different currencies. For example, it is not uncommon to have a group wide **reporting currency** such as **USD**, a particular customer being **invoiced in EUR** but **output VAT** being remitted to the UK tax authorities in **GBP.** In such scenarios, there are quite specific rules across the EU, requiring businesses to ensure that invoices quote either a **local currency equivalent VAT** amount, or a valid **exchange rate** that can be used when converting the foreign currency amount.

If such currency issues are handled manually at VAT return preparation stage, this indicates that your SAP system is not set up correctly. In fact, such exchange rate issues can be **automated** completely within the system. Such an approach requires the activation of Plants Abroad functionality and some **basic customising.** In order to use the Standard SAP currency conversion functionality for VAT reports, Plants Abroad needs to be activated (see fig below)

NO 09: YOUR TAX AUTHORITIES HAVE IDENTIFIED NON-COMPLIANCE DURING TAX AUDITS

It is often the case that underlying VAT issues can remain hidden until an audit by the tax authorities. Such audits can often uncover a variety of systemic issues leading to discrepancies within VAT reporting.

These can include (amongst others):

• Exempting cross-border supplies against an incorrect VAT ID number (e.g. one that does not belong to your legal customer for VAT purposes)

• Incorrect use of exemption texts on invoices

• Lack of sequential invoice number ranges per VAT registration

• Unexplained differences between VAT return figures and EC Sales Lists/ Intrastat declarations

Increasingly, tax authorities are focusing not just on the end result, but also the **underlying tax accounting** arrangements that taxpayers have in place. Given the transactional nature of VAT, configuration within the SAP system is increasingly part of this audit remit.

As a result, resolving such issues from a VAT audit perspective will often involve satisfying the tax authorities queries for the period in question, **as well as demonstrating an underlying 'fix'** to prevent such **systemic errors** being repeated in the future.

NO 10: YOUR SAP SYSTEM DOES NOT KNOW YOUR "LEGAL PARTNER FOR VAT"

SAP has a number of customising settings for defining who your legal partner for VAT purposes is. This is crucial as this partner will be used to determine whose VAT number should be reported on any invoice, and as such may be used to exempt a cross - border transaction.

Within SAP there are four partner functions:

• Sold-to • Ship-to • Payer • Bill-to

For more complex businesses, it is often the case, that the partner functions will not all be the same. If no decision is made, and the customizing setting for this is left as 'blank', SAP will use an inconsistent logic to determine the customer (varying depending on the exact scenario).

As a result, it is very important that businesses make a pro-active decision on which partner function they should be treating as their legal customer. For most businesses it should be the 'sold-to' as this will equate to your contractual customer.Increasingly, tax authorities are focusing not just on the end result, but also the **underlying tax accounting** arrangements that taxpayers have in place. Given the transactional nature of VAT, configuration within the SAP system is increasingly part of this audit remit.

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The following shows the customizing screen that is used to make this choice in SAP.

If 'A' is set, then the tax number and the tax classification are generally taken from the sold-to party.
The tax number is taken according to the 'tax country of destination'.

If 'B' is set, then the tax number and the tax classification are generally taken from the payer.
The tax number is taken according to the 'tax country of destination'.

ABOUT MERIDIAN

Meridian Global Services is a premier provider of comprehensive global tax determination technology for SAP, and also expert compliance and consulting solutions. With over 25 years of experience, Meridian's team of tax experts leverage their in-depth knowledge and expertise to help clients navigate complex global tax regulations and mitigate risks associated with cross-border transactions.

Meridian Global Services offers a suite of services, including technology solutions that enable automated SAP tax determination for on premise and cloud platforms. Meridian also provides global indirect tax compliance, global corporate tax compliance, trade compliance, and consulting services. The company's technology-driven approach provides clients with real-time visibility into their global tax obligations and helps them make informed decisions.

Meridian Global Services serves clients across multiple industries, including manufacturing, technology, pharmaceuticals, and consumer goods, among others. The company's mission is to simplify global tax compliance and help clients unlock the full potential of their global business.

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