

# Getting up to speed with VAT/GST in emerging markets

## A whole of business change

Emerging markets are at the forefront of the global shift from direct to indirect taxation. Reduced corporate tax rates in many countries and new or enhanced value-added-tax (VAT) or goods-and-services-tax (GST) are causing the shift.

VAT/GST implementation is invariably challenging, but there's no need to make it any more difficult than it needs to be by leaving it until the last minute or by only involving tax and finance teams. Your entire business needs to be responsive to this change as every function, from marketing to Human Resources (HR), will be affected. To minimise business disruption, thorough planning and disciplined project management, mobilisation and governance are required.

Drawing on insights gained from working with clients on the implementation of VAT/GST in a variety of emerging markets,<sup>1</sup> this article looks at how to make sure your business is up to speed with planning, applying the new requirements and dealing with the strategic implications. We also look at some of the lessons from the abandoned VAT introduction in Puerto Rico.

<sup>1</sup> These markets include Malaysia (2015), China (completed in 2016), India (due to go live in 2017) and the Gulf Co-operation Council (GCC) states (due to go live 2018-19).



In an earlier article,<sup>2</sup> we discussed why governments are looking to introduce or revamp VAT/GST systems and the business challenges this presents.

*The greater emphasis on indirect tax reflects an overall shift from taxing goods and services at the point of supply to where they're consumed.*

Consumption taxes like VAT/GST are recognised to be a more effective mechanism of capturing tax domestically in today's digital environment. Governments also like VAT/GST because it enables them to maintain tax revenues, while offering competitive corporate and personal tax rates. A well-developed and pervasive consumption tax allows multiple fiscal levers to be pulled to create a competitive tax landscape.

The GCC (Saudi Arabia, Kuwait, the United Arab Emirates, Qatar, Bahrain and Oman) is a telling example of taxation's direction of travel, as states that had been able to rely on oil and gas revenues for the bulk of government expenditure decide that they have to introduce VAT in the wake of subdued fuel prices. Unlike China and Malaysia, which have moved from a standard sales tax to VAT/GST, the GCC has no existing sales taxes and therefore the new tax is a cultural, as well as strategic and operational leap (see 'Spotlight on the Gulf').

India is also looking to boost tax revenue by moving its existing sales taxes to a new harmonised GST system. But the government's ambitions go further as GST filing and collection will be managed through a purpose-built technology network, marking the latest stage in the digitisation of public services. The challenges are heightened by the complexity of the IT demands and multitude of overlapping federal, state and inter-state GST (see 'Spotlight on India').

### Spotlight on the Gulf

#### Example of starting from scratch

The GCC members have relied heavily on the oil and gas sector to promote economic growth and fund public services. The recent decline in the oil price has seen these revenues shrink, with no tax base to provide other sources of income. The introduction of VAT in the GCC will therefore be especially challenging as many businesses have previously had little need to consider tax issues and their consequences.

The GCC states are expected to implement the VAT at the rate of 5%, with limited exceptions around food, healthcare and education. The United Arab Emirates (UAE) is likely to go live on 1 January 2018, with the remaining GCC member states looking to follow a year later.

We are expecting the GCC member states to shortly release the common framework for the VAT implementation which will form the basis of the VAT system for each GCC State. The legislation for the UAE is expected to shortly follow this framework.

### Spotlight on India

#### An example of harmonising multiple taxes

After a lot of legislative wrangling and delay, India's GST is finally expected to go live in July 2017. The new tax replaces a patchwork of different state and central government taxes, the anomalies and complexities of which have created considerable administrative headaches for companies. They've also made it hard to manage business seamlessly across multiple states.

The unification of the various levies is therefore a welcome step towards an integrated nationwide common market. Most of the state taxes will be replaced by a harmonised GST. Yet this opens up a fresh set of business-wide demands. Ensuring that businesses pay all that is owed and reclaim all that is due requires them to maintain a tax information system that mirrors the supply chain. A flaw or break at any point in the information system will compromise the tax credit chain for those higher up the supply chain and hence affect their ability to reclaim tax.

Further challenges come from the electronic sharing of data under the new GST, which forms part of the Government's drive towards greater digitisation of the economy and public services. With backing from central and state governments, a new non-profit making organisation, the Goods and Services Tax Network, is developing a comprehensive IT infrastructure capable of administering all areas of tax compliance, registrations and credit online. The digitisation of GST underlines the importance of an effective IT backbone, which is fully integrated into business and supply chain management.<sup>3</sup>

<sup>2</sup> 'Let's be clear, indirect tax is a business issue' (<http://www.grantthornton.global/globalassets/1.-member-firms/global/insights/article-pdfs/2016/lets-be-clear-indirect-tax-is-a-business-issue.pdf>)

<sup>3</sup> Further information on the GST implementation in India is covered in the blog 'Getting ready for GST in India: The importance of bringing the whole business on board'.

### Addressing the issues and complexities

VAT/GST is far more complex than a standard sales tax. Unlike a sales tax, VAT/GST is levied on the difference between the purchased and the resale price. As such, businesses can reclaim as well as pay tax, and therefore the net result should, in theory, be neutral. In practice, VAT/GST systems heighten the operational demands and risk for error.

Our experience of implementation in both developed and emerging markets suggests that the business impact of VAT/GST is often underestimated, leading to under-resourcing and inadequate preparation time.

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*The big danger is thinking of VAT/GST as simply a sales tax or as a fairly simple change, only affecting the tax and wider finance teams.*

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In reality, there are multiple issues and complexities to consider and address:

#### 1. Political sensitivity

As VAT/GST systems affect consumer prices, their introduction is bound to be contentious. An example was the opposition to GST in India that led to legislative delays (mostly now overcome). In Puerto Rico, the introduction of VAT was effectively abandoned just weeks before it was due to go live, following a binding vote by the legislature. (The Governor had vetoed the cancellation, but this was then overruled by the legislature, the result of which was the effective cancellation of VAT.)

Naturally, your business won't want to invest too much money and effort until you're sure about what's going to happen. But it's still important to plan ahead rather than waiting for legislation to be finalised, as you could easily be caught unawares. The experience of many companies in Malaysia highlights the risk (see 'Spotlight on Malaysia'). A VAT readiness project helps your business to discover internal controls weaknesses and areas of non-tax compliance. This was certainly the experience of the businesses that we assisted in Puerto Rico, which used the opportunity to lower their risk.

#### Action

The fine line between doing too little and doing too much, too soon, highlights the importance of a pragmatic, phased approach to planning and implementation. This would begin with an impact assessment and then the planning and allocation of responsibilities needed to ensure the business is ready to mobilise, while aligning more detailed preparations with political and legislative developments. The level of work undertaken should match your business' overall risk appetite.

#### 2. Price, profit and reputation

The price increases arising from a new VAT/GST create marketing and reputational issues. Clearly, some prices will rise as a result of the tax, but companies often under-estimate the additional impact of higher systems and compliance costs. A key question for your business is how to remain price competitive under the new system. Our experience also highlights the risk of being seen to profit from the change, which can cause severe reputational damage. You're especially likely to be in the firing line if you increase prices before the new tax system goes live, the rises go beyond the rate of tax or you fail to pass on some of the savings from any refunds or reduction in corporate taxes. You might even run into trouble by rounding up prices for consumer convenience.

The reputational risks are heightened by the anti-profiteering legislation that either predates or accompanies the introduction of VAT/GST – as has been the case in Malaysia and Australia. There will often be high profile prosecutions as a result of the legislation, which generally stem from a lack of understanding of how the new tax affects pricing and supply chain decisions.

#### Action

The impact of higher costs should be carefully mapped, understood and managed. If your business is clear about the impact and is ready to respond, you can use the change-over as a commercial opportunity through such moves as selective price offers to undercut less prepared competitors.

### Spotlight on Malaysia

#### Highlighting the risks

Malaysia introduced a GST in April 2015. The experience highlights many of the continuing challenges and risks.

#### 1. Caught unawares

GST had been postponed twice before it was finally implemented in 2015. In the months leading up to the eventual implementation, many businesses were anticipating yet another deferral, only to be caught out when this didn't materialise and the system went live. A lot of companies have subsequently lacked the documentation needed to make claims for refunds or deal with surprise audits.

#### 2. Controversy

By setting the GST at a level generally lower than the sales tax and service tax it replaced, the government presented the GST as being fairer. But because the GST covered more goods and services than before, many people felt that it was actually less fair. To win public support, the government granted various exemptions and many goods were zero-rated. Unfortunately, these concessions have added significant extra complexity to the implementation and operation of the GST.

#### 3. Profiteering exposed

Malaysia already had tough anti-profiteering legislation in place ahead of the introduction of the GST. The new GST has greatly added to the risk of investigation and prosecution. Those facing court action and heavy fines has included stores that were found guilty of increasing their profit margin on particular products after the change-over.

#### 4. Systems overload

Along with periodic digital reporting, Malaysian businesses are required to maintain detailed data in a GST Audit File (GAF). The GAF provides tax auditors with key information for review and investigation, including general ledger transactions and supply and purchase records. Implementation has proved to be a highly complex exercise – even after nearly two years of operation, many companies are still struggling with the demands.

#### 3. Operational challenges

From applying the tax rules to individual products through to filing and payment, the operational demands of VAT/GST are much greater than a standard sales tax.

In many instances, the political reasoning for passing legislation is the exemption of multiple products. This eases the impact on disadvantaged consumers, but makes VAT/GST much harder for businesses to implement and operate.

As the experience in Malaysia and now India shows, moves to VAT/GST often form part of a wider programme of tax reform and modernisation. A key element of which is the digitisation of tax record-keeping and filing. Globally, tax authorities are also moving towards big data audits, which require robust reporting. Digital record-keeping and filing not only increase systems demands, but also raise questions over protection against cyber threats, how tax authorities will use the information and the extent to which it will be exchanged between government departments and other tax authorities.

And the complexities permeate further into the business. For example, the costs of employee entitlements may change, which would bring payroll and HR into the picture and open up the additional challenges of VAT/GST recovery and interaction with remuneration taxes.

#### Action

Your impact assessment should look closely at the data and systems demands, how VAT/GST fits into wider developments in tax reporting and its interaction with other tax requirements.

#### 4. International reach

VAT/GST isn't just an issue for local businesses. Understanding VAT/GST liabilities and claims across multiple cross-border operations is proving to be increasingly difficult for multinational groups. Key challenges stem from a complex web of place of supply and consumption tax rights, which differ from country to country, between goods and services, and between business-to-business and business-to-customer commerce.

Working with companies in Malaysia and its neighbours, such as Singapore and Thailand highlights the challenges. Many are centring on the country's place as a gateway for goods and services coming from Europe into South East Asia.

And no two systems and the challenges that come with them are identical. The distinctive issues within particular territories range from the culture shock of bringing in VAT/GST without the foundation of a basic sales tax in consumer minds (eg GCC) to the systems demands built into legislation (eg India).

#### Action

Within today's complex supply chains, it's hard to track which territories are touched by the incoming and planned changes to VAT/GST and whether this could trigger any new liabilities. It's therefore important to develop a clear overview of where you're liable, what your obligations are, and how these interact across your supply and sales chains. Modifications to supply chains may be necessary.



If we put these multifaceted and often overlapping challenges together, it's clear that VAT/GST is a whole of business change, which touches multiple business operations in varying degrees (see Figure 1).

**Efficient implementation**

As the differences between VAT/GST systems in India, China, the GCC and Malaysia highlight, there is no common preparation for implementation in emerging markets. But certain fundamentals apply when planning and applying the changes:

**1. Instil cross-organisational awareness**

The clear message from the outset should be that VAT/GST implementation is a whole of business change, rather than just a tax or finance compliance project.

Education and training are needed from an early stage to ensure everyone from the board to sales, marketing and HR teams are fully aware of what's involved and their particular role in addressing it.

Our experience shows that effective awareness training is the 'lightbulb' moment, which paves the way for timely and efficient implementation across the organisation. It's also important to establish clear executive sponsorship at this early stage to ensure VAT/GST is given sufficient priority.

**Figure 1: Gauging the cross-functional impact of a move to VAT/GST**

	General awareness	Legal accountability	Compliance	IT changes	Pricing changes	Operational changes
<b>Executive level management</b>	✓	✓			✓	✓
<b>Departments</b>						
• Accounting and finance	✓	✓	✓	✓		✓
• IT	✓		✓	✓	✓	✓
• HR	✓		✓			✓
• Legal	✓	✓	✓			✓
• Operations	✓			✓		✓
• Procurement	✓				✓	✓
• Sales and marketing	✓				✓	✓
<b>General staff</b>	✓					✓

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**Risk and benefits**

**If your business is poorly prepared, you risk:**

- Adverse profit and loss (P&L) impacts from lack of pricing and supply chain awareness
- Non-compliance and tax audits
- Reputational and commercial damage
- Shortfall in tax reclaimed and resulting cash flow difficulties
- Operational inefficiencies, the cost of which would eventually have to be passed on to customers.

**If your business is up to speed, the benefits include:**

- Opportunities to plan targeted offers and undercut competitors
- Tax authority confidence and reduced risk of audit/investigation
- Opportunity to develop a whole tax approach that uses efficiency savings and possible reductions in other tax demands to control prices
- A catalyst for systems upgrade as part of wider tax and finance transformation.



## 2. Business and supply chain mapping

Comprehensive mapping of the impact and assignment of responsibilities are the other key foundations for the phased approach to implementation.

Early evaluation of the legislation and its impact will enable issues to be addressed with enough time to minimise deficiencies ahead of a go live date. You can then align more detailed preparations around government guidance on timing, expectations and roll-out, while building in contingencies for political developments and the possible delays, modifications and even derailing of plans that these might entail.

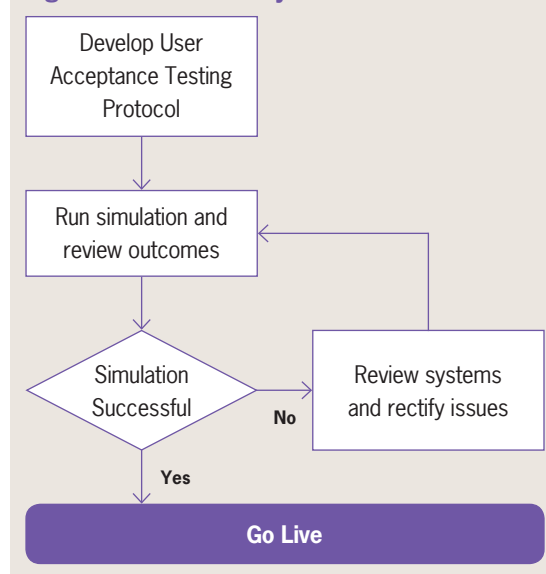
Implementation projects require many stakeholders to engage and collaborate. Even if details of legislation aren't finalised, a lot of the preliminary work can be completed on an 80:20 basis. Businesses tend to wait until the legislation has been enacted and operational before investing in a VAT readiness programme. As outlined earlier in this article, in our experience businesses that have made the investment early on have benefited by minimising their risks and using the experience to look at their overall strategy.

## 3. Strategic assessment/planning

Business teams should look closely at the implications for pricing, marketing and supply chain management.

The strategic assessment should also look closely at systems demands as time needs to be allowed for selection, installation, training and testing (see Figure 2). A key part of this is matching compliance, filing and management information requirements with vendor specifications and the particular demands of your business (i.e. the interface with current business and also tax authority systems). The evaluation should also be as forward looking as possible because systems demands on tax are increasing all the time.

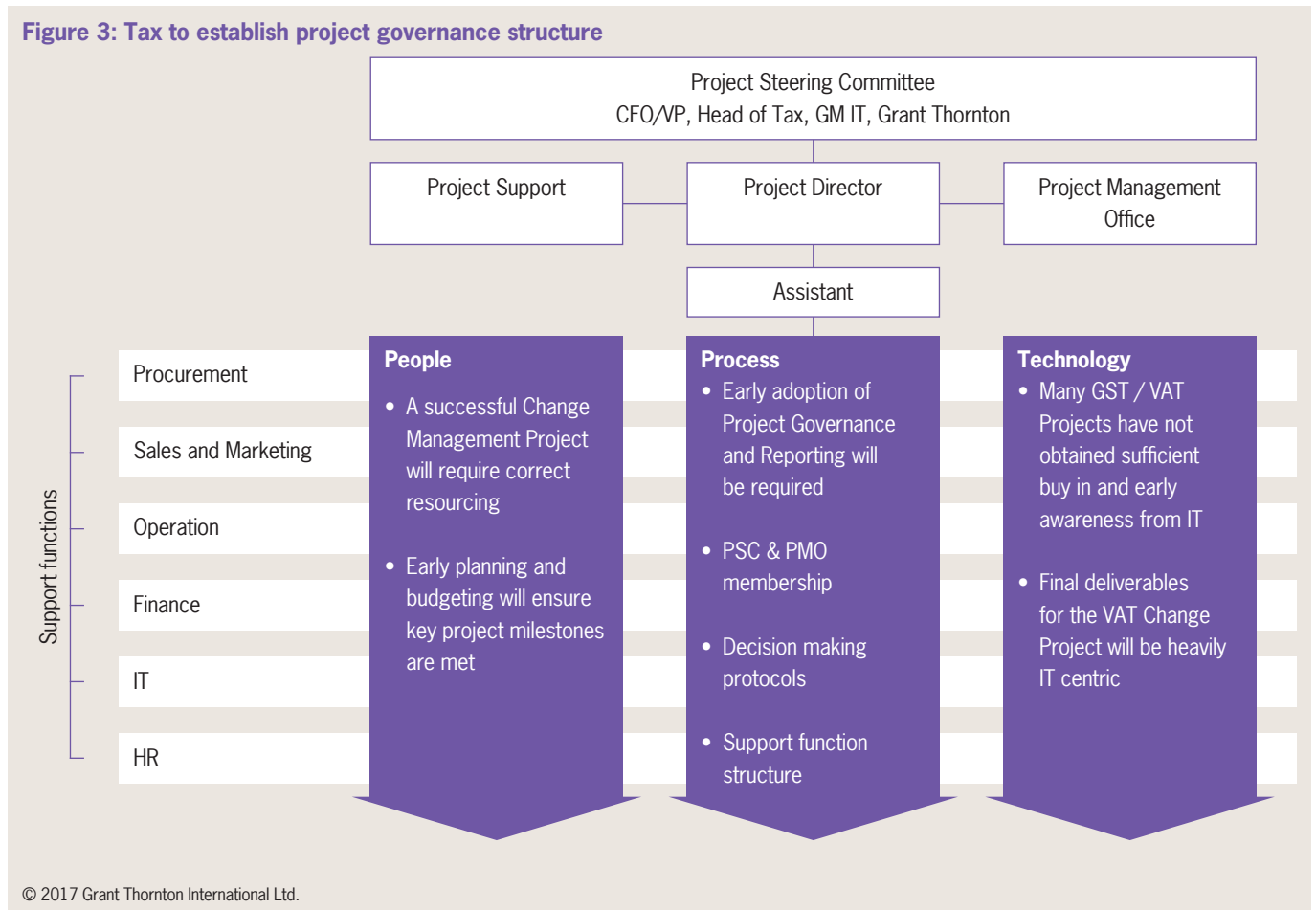
Figure 2: Information systems



#### 4. Project governance

It's important to assess resourcing priorities and put in place a project governance framework as early as possible (see Figure 3).

Figure 3: Tax to establish project governance structure



The VAT/GST governance and compliance framework should focus on the fundamental areas of people, processes and technology. This will ensure the implementation project can move to business-as-usual in a timely and sustainable way.

Experience shows that many businesses have focused on 'front end' issues such as customer experience (eg pricing), but have not considered 'back office' governance and compliance as important – often to their detriment. The key test is when VAT/GST returns have to be filed on a regular basis, but it transpires that the data collection and reporting systems can't provide the required information. Additionally, internal audit will be closely scrutinising the value, efficiency and risks of VAT/GST, with any deficiencies in implementation likely to require immediate and potentially costly remediation.



## 5. Project plan

Clear project management is vital. All stakeholders should come together to determine time frames and key milestones. Recent experience indicates that you should allow at least 12 months to plan and implement. This is especially relevant when looking at IT requirements.

Businesses that have allowed this time face less disruption and tend to make fewer initial errors than those who leave the standard three to four months.

You can't simply deploy lots of people at the end. Understanding, co-ordination and effective systems, plus monitoring capabilities are vital operationally and in minimising the risk of compliance lapses. A last minute labour-intensive approach is also often financially unsustainable.

## 6. Hand over and operationalisation

It's very likely that tax, strategy and project management consultants will play a crucial role in planning and implementation. Support should include how to move to an in-house business-as-usual operation. A key part of this is the governance and compliance framework, along with staff training in readiness for going it alone.

## Ready to go

VAT/GST is a competitive rather than just compliance issue. Sales, marketing, HR, legal and procurement departments all need to be aware and actively participating in a shift that affects multiple parts of the business, some aspects of which won't be evident until you carry out an organisation-wide impact assessment.

The better prepared your business is, the bigger the opportunity. If your organisation isn't sufficiently aware, mobilised and strategically and operationally ready to go live, the bigger the risks of adverse P&L impacts, non-compliance/tax investigation, reputational damage and cash flow problems.

If you would like to talk about any of the points raised in this article, please speak to one of the contacts listed below or your local Grant Thornton contact:

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### Switzerland

Dr. Stephan Baumann  
E [stephan.baumann@ch.gt.com](mailto:stephan.baumann@ch.gt.com)

Dr. Matthias Hofer  
E [matthias.hofer@ch.gt.com](mailto:matthias.hofer@ch.gt.com)

### India

Vikas Vasal  
E [vikas.vasal@in.gt.com](mailto:vikas.vasal@in.gt.com)

Krishan Arora  
E [krishan.arora@in.gt.com](mailto:krishan.arora@in.gt.com)

### Australia

Tony Windle  
E [tony.windle@au.gt.com](mailto:tony.windle@au.gt.com)

### United Arab Emirates

Gurdeep Randhay  
E [gurdeep.randhay@ae.gt.com](mailto:gurdeep.randhay@ae.gt.com)

### United Kingdom

Karen Robb  
E [karen.robb@uk.gt.com](mailto:karen.robb@uk.gt.com)

### United States

Rob Clarke  
E [rob.clarke@us.gt.com](mailto:rob.clarke@us.gt.com)

Adam Raschke  
E [adam.raschke@us.gt.com](mailto:adam.raschke@us.gt.com)





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