

Patrick Walker, UK Indirect Tax Leader, PricewaterhouseCoopers looks at the likely impact EU Accession will have on shared service centres and reviews the current status of VAT invoicing and VAT harmonisation in the EU.

EU accession – a new opportunity for shared service centres

The major VAT impact to shared service centres (SSCs) in 2004 will be the EU enlargement involving the admission of 10 new countries on 1 May, less than one week from the publication of this article. If SSC management have not prepared for this event they could face difficulties, particularly as they may be exposed to new fiscal authorities, penalty regimes and new business cultures.

As a result of EU accession, SSCs are likely to require significant IT input, and will need to restructure business processes, make changes to VAT invoicing, and revise legal and accounting rules. However, it's not all bad news. There will be further opportunities for increased economies of scale as the legislation in accession countries should be broadly compliant with the EU Invoicing Directive provisions, and thereby allow economies of scale over 25 countries. In addition, many businesses are considering relocation of existing SSCs to these potentially lower cost jurisdictions.

EU harmonisation - a new dimension for VAT?

It is accepted that SSCs offer significant benefits to an organisation in terms of cost-reduction, accuracy, time efficiency and centralised controls. The basic tenet of an SSC is to provide high-quality, non-core services to the business, at a lower cost and more efficiently than the business could otherwise provide for itself. Furthermore, SSCs normally operate without geographical constraint and can therefore take advantage of favourable tax regimes, incentives and labour markets available in different parts of the globe.

Nevertheless, establishing an efficient SSC operation is not without its difficulties. Challenges typically exist in relation to staff retention, employee reward, and local infrastructure. Most businesses with an SSC will also recognise that a ‘trade off’ often exists between maximising efficiency via heavily standardised processes and ensuring specific country fiscal compliance.

As SSCs adopt a heightened global dimension, this ‘trade-off’ can become more onerous. For example, even within the relatively mature arena of the current EU, a multitude of different VAT rules exist on invoicing, audit requirements and record retention, and such requirements can prove difficult to manage. The imminent expansion of the EU is likely to exacerbate this situation. Indeed, due to the many staff, regulatory and taxation issues, many businesses have questioned their ability to capture the potential cost savings available via a single global SSC. Instead, many businesses have opted to remain ‘de-centralised’ in either regional SSCs, or retained non-core services ‘in-house’ in local business units.

For those businesses who have elected to operate a EU SSC however, it is vital to maintain overall compliance if they are to continue to fulfil their cost saving objectives. For instance, given the potential penalties available to fiscal authorities for cases of non-compliance, there is a risk that businesses erode costs savings via regulatory breaches. This is a greater priority for management of organisations where the SSC function is outsourced or exists ‘remotely’ elsewhere in the world.

EU Invoicing Directive – bane or blessing?

The implementation of the EU VAT Invoicing Directive on 1 January 2004, designed to ‘simplify, modernise and harmonise EU invoicing’, directly impacted upon SSCs. In theory, they should be the biggest beneficiaries of the Directive as it promotes standardisation and harmonisation of invoicing rules - particularly on invoice content, electronic invoicing, storage, self-billing and outsourcing. In practice however, some countries have yet to fully adopt the Directive, whilst others have adopted certain ‘discretionary’ rules; it is such circumstances that could potentially harm the objectives of the Directive and prevent it from securing what it originally set out to achieve.

More worrying perhaps is that not all SSCs will have recognised each EU countries’ use of the Directive’s ‘discretionary’ clauses, and are therefore potentially exposed to financial penalties as a result. If so, with the new legislation in its infancy, now is an opportune time for management to review SSCs compliance and simultaneously maximise the potential benefits that the Directive does undoubtedly offer, such as the opportunity to issue invoices electronically throughout the EU.

Clearly, this could have a significant impact on SSC costs, as it is widely accepted that issuing an electronic invoice can be up to ten times more cost effective than paper invoices. Given these potential savings, and the increased scope arising from EU expansion, certain businesses may find it worth implementing electronic invoicing solely on an ‘internal’ intra-group basis or making use of greater savings available for supplies to ‘external’ business customers.

The use of electronic invoicing does come with stipulations however, such as the form of electronic signal to be used (Electronic Data Interchange (EDI) must be

accepted by all EU countries) and the provision of guarantees of authenticity of origin, and integrity of contents via the use of advanced electronic signatures.

The Directive has also been constructive in persuading fiscal authorities to consider other 'business friendly' electronic invoice transmissions, such as web-placement and email delivery. Certain EU countries, such as Belgium and the UK, have a willingness to accept these arrangements, although it should be borne in mind that many EU countries (such as Luxembourg) will still not permit such transmissions. Where EU Member States do permit invoices to be transmitted by other electronic means (other than EDI or advanced electronic signature), the criteria that must be met in each EU Member State will vary.

Management of SSCs will be keen to learn, however, that certain EU countries (such as the UK) may allow the archiving of records in any format and at any location, provided the integrity of the documents is guaranteed during the storage period, and records are made available for tax authority inspection. Again, the ability to store documents outside of a specific EU country can still depend upon local fiscal authority approval (for instance, Belgium does not normally permit this). Hence, for those businesses operating a single global SSC, the rules regarding document retention must be considered closely. For example, several EU Member States will not allow documents to be stored outside of the EU, while the ability to store documents in a country may also depend upon the existence of non-VAT related mutual agreements between specific countries (for example, in relation to data protection regulations).

Furthermore, EU countries can require invoices to be archived in their original format and limit the ability of businesses to automatically 'scan and destroy' invoices, which can be a key business driver for a SSC.

A further benefit that the Directive now offers is the ability for businesses to 'self-bill' on an international basis. Again, conditions apply. Regardless of the hurdles those businesses might encounter through self-billing, this is another step forward for those pursuing administrative efficiency – and self-billing can also improve cash-flow in certain cases.

While the Directive does not provide the level of EU harmonisation it once promised, it does provide new opportunities for SSCs to streamline their operations and further reduce costs by taking full advantage of the options available. Interestingly though, by the end of last year more than 50 percent of businesses were neither aware nor fully prepared for the new regulations. Although awareness is increasing and many business plans now include objectives to increase the level of invoices issued electronically.

Importantly, at this key planning stage businesses need to recognise that no 'one-size-fits-all' solution can be applied to SSCs under the Directive. But, there is specialist advice available to make life a little easier for those businesses.

SSC implementation/review – a suggested approach

In cases where a business is setting up an SSC for multi-country electronic invoicing or reviewing overall SSC compliance, the following approach has proven to be successful from a VAT perspective.

It is essential to understand from the outset not only what the business objectives and constraints are, but also the detailed local requirements on a country-by-country basis. To that end, it is recommended that businesses initially establish a project team that can provide input from a tax, legal, IT, HR and operational perspective.

Following an initial information gathering exercise, it is useful to complete a matrix that maps on one hand the detailed requirements in the relevant countries, and on the other, the potential SSC solutions available. Following this activity, businesses should carry out a risk assessment to validate whether its invoicing and record retention systems comply with the provisions of the Directive and also the relevant national regulations.

In many cases, businesses' ERP systems will also require configuration and the IT technical team will need to have a full understanding of the compliance requirements to ensure these are incorporated into the operational system and process design. This extends beyond merely VAT considerations, as the business will also need to assess direct tax, accounting and legal implications as well. In addition, when operating in a multi-language environment, English is not always an option and ERP systems must be leveraged to meet local language and invoice requirements.

On the basis of this validation, the most suitable SSC invoicing solution can be identified and the implementation stage can begin. However, from practical experience, businesses can often commence invoicing electronically in many countries immediately.

Lastly, businesses should recognise the importance of conducting post implementation reviews and on-going review programmes. Not only does this allow the business to monitor changes to ensure compliance on invoicing and archiving systems, but it will also ensure that overall operating efficiency is maintained and that the SSC continues to meet the specific needs of the business users.

EU accession – a period of change

There is no doubt that EU expansion marks a period of considerable change for SSCs. But remember, not all change is necessarily bad news and considerable opportunities are available as well. As always, businesses prepared to reconsider current processes and carefully manage resultant changes stand to gain the most from the new invoicing rules and the further EU harmonisation across 25 countries. In many countries, the tax authorities will operate the new requirements with a light touch during 2004 and therefore this is good opportunity for businesses to use this breathing space to implement the necessary changes.

Our final words of advice: be prepared and be quick to adapt to change if you want to deliver a lean, standardised and efficient service.

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