YOUR GUIDE TO CROSS-BORDER VAT

A comprehensive guide to current tax trends and upcoming developments in VAT

Avalara
Tax compliance done right

GUIDE

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ABOUT AVALARA

Avalara makes tax compliance faster, easier, more accurate, and more reliable for 41,000+ business and government customers in over 75 countries. Tax compliance automation software solutions from Avalara leverage 1,200+ signed partner integrations across leading ecommerce, ERP, and other billing systems to power tax calculations, document management, tax return filing, and tax content access.

Visit **avalara.com** to improve your compliance journey.

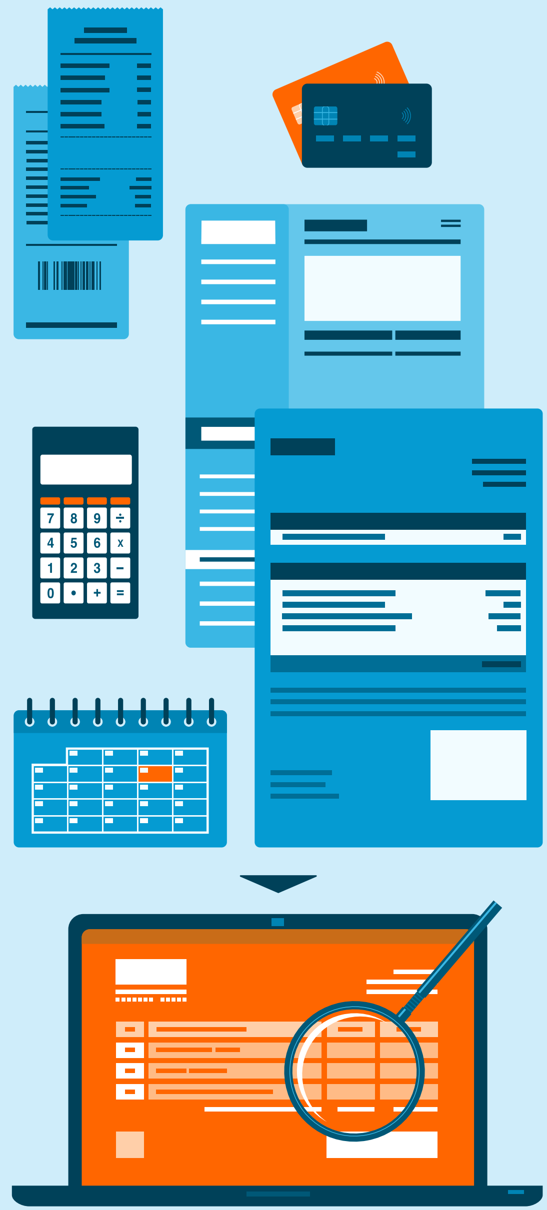
Introduction: The digitalisation of VAT

Value added tax (VAT) was first introduced by France in 1954 and later became mandatory for members of the European Economic Community (EEC) – now the European Union (EU). VAT was introduced in the U.K. in 1973 when it joined the EEC.

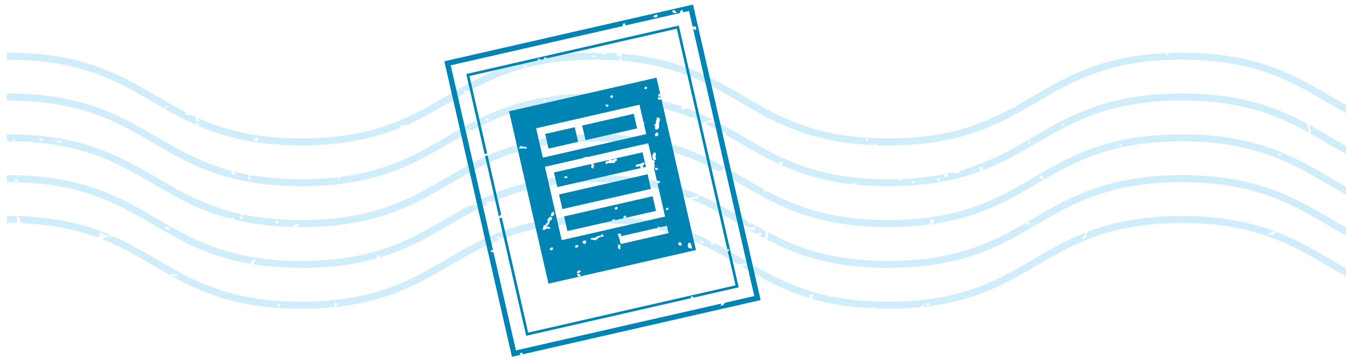
As VAT is charged at every stage of production and distribution, its introduction was a way for governments to reduce tax evasion and increase revenue. VAT also spread the tax burden across multiple stages of production instead of only sellers and buyers, helped to standardise taxation and align with international trade standards, and – as it's typically refunded on exported goods – encouraged cross-border trade.

Technology and how we do business have changed since VAT's introduction. And levels of cross-border trade are higher than ever. How VAT is administered has had to evolve, and tax authorities continue to digitalise VAT compliance. Online portals and digital schemes are almost entirely replacing paper-based taxation. VAT in the Digital Age (ViDA) is a package of EU reforms designed to digitalise the administration of VAT in response to Europe's growing digital economy. The U.K. (no longer a member of the EU) has developed Making Tax Digital (MTD) – a similar initiative to make VAT administration more efficient and easier for taxpayers by moving to digital submissions and record-keeping.

This guide can help prepare your business for the year ahead and the VAT compliance challenges you may encounter.



E-invoicing



E-invoicing – the electronic transmission and processing of invoicing data in a structured format – is a hugely important aspect of international VAT compliance. A number of e-invoicing mandates are in place in countries all over the world, and their rollout will continue. Being prepared for e-invoicing should be high on any business's agenda, even if based in a country where mandates are not yet in place. At some point, they will be.

E-invoicing is not currently mandatory in the U.K. for B2B supplies, though it can be used by businesses on a voluntary basis. In September 2024, U.K. Chancellor Rachel Reeves announced the launch of a public e-invoicing consultation to promote the wider use of e-invoicing and real-time reporting across Britain. The consultation will gather feedback from U.K. businesses to better understand how His Majesty's Revenue and Customs (HMRC) can support e-invoicing adoption.

The introduction of e-invoicing is the new regulation that appears to be affecting businesses and tax teams the most. But why is this gaining so much momentum?

Benefits

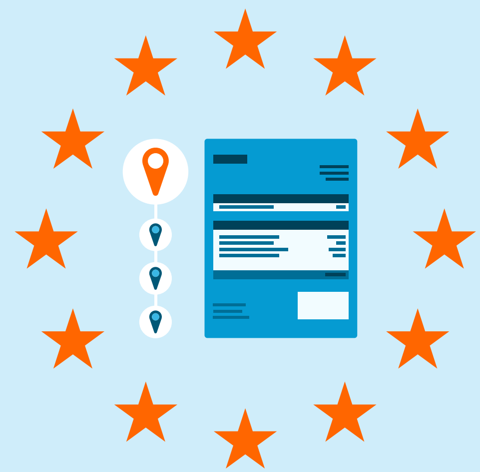
E-invoicing is proving to be beneficial for businesses and tax authorities alike. E-invoicing can reduce the costs of invoicing for both parties by automating paper-based and time-consuming manual processes. Other commercial benefits include boosting efficiency and reducing errors associated with manually keying in data. By sharing encrypted data, e-invoicing is also a more secure transmission method than mail or email.

Because tax authorities receive tax data in real time, they gain a more up-to-date picture of VAT income and economic trends, and deeper insight into transactional data. It also helps governments to close their VAT gaps – the difference between the amount of VAT collected and the amount owed.

Italy has already managed to reduce its VAT gap by almost 11% with the help of e-invoicing. Similarly, Poland's gap has closed by almost 8%. In her September announcement, the U.K. chancellor also announced one of the priorities for HMRC to be closing the U.K. tax gap, which currently stands at an estimated £8.1 billion.

Proven success and benefits to businesses and governments alike means the uptake of e-invoicing and real-time reporting in most, if not all, countries with VAT systems is a matter of time.

Simplified compliance schemes



As a business expands into new markets its compliance obligations naturally grow and become more complex. VAT responsibilities are no exception. Prior to 2021, a business selling into the EU would need to register for VAT in each country it was selling into. Doing so made it necessary for the tax team within the business to understand and comply with the tax rules of each individual country, which could get very complicated.

Simplified compliance processes like the One-Stop Shop (OSS) and Import One-Stop Shop (IOSS) – introduced in 2021 – reduce the need to file complex registrations and returns in multiple countries, which can be time-consuming for businesses, by allowing businesses to register in a single member state and declare all VAT from operations across the EU in a single EU VAT return.

Simplified compliance schemes originally applied only to lower valued goods. Within the EU, the threshold was set at €150. Having determined these thresholds were detrimental to international trade, authorities removed them.

Understanding simplified schemes and how to register for them could save your business time and money. It's possible systems such as IOSS will become mandatory in the near future, at which point non-EU businesses would have to register or risk becoming noncompliant.

VAT and importing

Trading goods internationally can be a complex prospect. In addition to managing the customs rules of each country you sell to, you'll need to account for their VAT rules, since import VAT is due when you bring goods across borders. Compliance errors when importing can lead to unnecessarily high VAT and duty fees, so it's important to know how to comply when importing goods.

The all-important EORI number

If you're performing a compliance audit, a great place to start is the Economic Operators Registration and Identification (EORI) number, which is an essential piece of identification any business needs for selling goods into or out of the EU. Just as your business has an identification number for all VAT-related interactions, the EORI number is used when dealing with European customs (as well as customs in the U.K. to a certain extent).

If you're VAT registered in the EU, you'll automatically receive an EORI number during registration. However, if you've only just reached the VAT registration threshold, you may need to take steps to link your new VAT number with your EORI number. Doing so allows you to link your customs declarations with your VAT reporting, which can simplify compliance greatly.

Double-check your HS codes

Harmonised System (HS) codes are multidigit identifiers assigned to every product sold across international borders. They enable customs authorities to apply the correct duties and taxes to every product. A common customs compliance error for businesses is getting their codes right. This can be a **weak spot** for businesses, as the same product can have different codes in different global regions, and the codes are frequently updated and amended. Getting them wrong can impact your revenue – you could be charged the maximum possible customs duty for your shipment, your goods could be returned, and customers could be liable to pay for the release of their items (which won't have them rushing back to buy again any time soon). **Avalara Item Classification** can do the hard work for you. It can identify and automatically apply the correct HS codes to your goods, reducing the risk of additional costs, unnecessary customs holdups, and disappointed customers.

Import now, pay VAT later

Most countries encourage international trade, rather than block it by creating difficult or complex tax barriers. Postponed VAT accounting (PVA) is an example of how tax authorities can make cross-border trade easier for businesses. Historically, import VAT would need to be paid before customs would release goods back to a business. With PVA, goods can be released immediately and paying the import VAT can be delayed until the business files a VAT return.

Keep in mind that even in the EU, PVA is not available in every country. Additionally, there may be prerequisites to using PVA or a registration process. For example, **the U.K. PVA system** requires businesses to be VAT registered in the U.K. and to be registered with the Customs Declaration Service. Although registration can take time, the improved cash flow and streamlined import process that PVA creates can be well worth it.

How are you importing your goods?

Despite their importance, VAT and customs compliance are often low on the priority list for businesses because they don't directly increase revenue. However, international businesses can significantly reduce the cost of cross-border trade if they have a solid understanding of customs compliance. For example, both import VAT and customs duty can be minimised by leveraging the EU customs union. The customs union allows for goods to be transported freely within the EU, meaning no customs duty is due on trade between member states. If you import significant shipments into multiple countries, look into how your shipping costs stack up against your customs fees: it may be cheaper to import goods into a single country and have goods transported across internal EU borders from there.

Similarly, customs warehouses and free trade zones can provide significant savings opportunities for your business. By importing your goods into a customs warehouse (or bonded warehouse), you can delay the payment of import VAT and customs duty until the sale of your goods is finalised. However, you do need to apply for the use of a customs warehouse and that **application has several requirements**.

A free trade zone (or freeport) offers the same benefit (i.e., delayed tax and duty payments) but extends further than a single building. Businesses can set up offices or even manufacturing facilities within a free trade zone and are often offered substantial tax incentives to do so.

VAT and SaaS: Tax in digital industries

VAT can be applied differently to digital goods and services, depending on how countries classify them. Much of the distinction is based on the fact that digital goods and services can be sold instantaneously across borders, so traditional rules for importing and the point of sale tend not to apply.

It's crucial for digital service providers to identify who they're selling to and where that customer is based, as both factor heavily in the application of VAT. If an EU business sells digital services to another business (i.e., B2B transactions) then the customer must account for VAT **and the reverse charge rule applies**.

When an EU business sells digital services to an individual, then the important part is identifying where the customer is, as VAT rates are calculated based on the customer's location. Locating customers **is a common VAT issue for digital service providers**: knowing a customer's location is essential for VAT calculation and reporting, but the speed and anonymity of B2C digital sales make gathering information difficult.

Additionally, digital service providers in the EU should be aware that they'll use the same simplified compliance scheme as any other business (the OSS). Until 2021, digital service providers used Mini One-Stop Shop (MOSS) for VAT returns. This service has now been phased out and companies selling digital services have been redirected to use the new OSS instead.

How Avalara can help

Avalara helps businesses of all types and sizes simplify their VAT compliance, so they can spend less time on the complexities of international tax and more time focusing on their goals.

For any of the VAT challenges discussed, there's an Avalara solution:

Accelerate tax calculations

Distance selling makes it difficult to price your goods because you need to account for variables like import VAT and customs duty. Avalara AvaTax calculates the relevant tariffs instantly, allowing you to provide a more accurate final landed price for your customers.

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Streamline e-invoicing

With multiple e-invoicing mandates across Europe, international businesses need a solution. Avalara E-Invoicing and Live Reporting scales with your business, and frequently updates to cover new mandates and requirements.

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Simplify VAT reporting

Although IOSS means only a single VAT report is needed for businesses selling to multiple EU countries, it's still important to have a way to generate more accurate and compliant reports. Avalara offers a comprehensive digital solution with Avalara VAT Reporting software, as well as Avalara Managed VAT Reporting for larger companies.

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Disclaimer

Tax rates, rules, and regulations change frequently. We hope you find this information helpful; however, this resource is for informational purposes only and does not provide legal or tax advice.

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