



## WHAT ARE YOU SELLING? - AN INTRODUCTION TO THE MATERIAL TAX CLASSIFICATION (MTC):

If a customer wants to buy goods or services from you, your sales department will create a sales order in SAP. The goods and/or services will be represented in the sales order with a 'material number' (or 'article number' as some would call it).

Each material number in SAP needs to be identified for tax purposes, so that the correct taxable status can be recognized in the system.

**For example**, are the materials you selling goods or services? Are these goods or services standard rated, reduced rated, zero-rated, or perhaps exempt, etc.?

The taxable status of each material number in the SAP system is captured within the master data under the '**m**aterial **t**ax **c**lassification' ('**MTC**').

### **TO WHOM ARE YOU SELLING?** - AN INTRODUCTION TO THE CUSTOMER TAX CLASSIFICATION (CTC):

When a customer buys goods or services from you, your sales department will create a sales order in SAP. Each sales order will contain several 'partner roles', including a:

- (sold-to' partner (generally refers to the legal partner for VAT purposes\*)
- 'ship-to' partner (represents the physical location where the goods are delivered to or services are performed)
- 'payer' (the partner that will pay for the goods and/or services received)
- 'bill-to' partner (the physical address to where the invoice will be sent)

(\*) The determination of the legal partner for VAT purposes has been discussed in one of our video articles and can be accessed here-> <u>https://www.meridianglobalservices.com/insights-who-is-my-legal-partner-for-VAT-purposes/</u>

Each partner number in SAP (that is regarded as the legal partner for VAT) needs to be identified for tax purposes, so that the correct taxable status can be recognized in SAP.

**For Example**: is the customer liable for VAT, not liable for VAT, does the customer belong to a VAT group or a fiscal unity, does the customer have a special exemption certificate etc?

The taxable status of the legal partner for VAT purposes in the SAP system is captured within the master data under the '<u>c</u>ustomer <u>t</u>ax <u>c</u>lassification' ('**CTC**').



# WHERE IN SAP IS THE MTC DEFINED?

The MTC is stored within the material master data view 'Sales org. data 1'. The figures below will show you the path to the MTC settings:

- 1. Start-up transaction MM02 (change material master data) or MM03 (display material master data)
- 2. Fill in the material number and 'enter':

<b>I</b>		×		0
Change	Mate	rial (Initial	Screen)	)
Select Vie	ew(s)	Org. Levels	Data	
Material	n	meridiangoods	đ	
Change Numb	er			

3. Select the view 'Sales: Sales Org. Data 1' and 'enter':

🗲 Select View(s)		>
View		
Basic Data 1	^	
Basic Data 2	<u>×</u>	
Classification		
Sales: Sales Org. Data 1		
Sales: Sales Org. Data 2		
Sales: General/Plant Data		
Foreign Trade: Export Data		

4. Fill in the organisational levels and 'enter':

🔄 Organizational L	evels		×
Organizational leve	els		
Plant	be10		
Sales Org.	be10		
Distr. Channel	10		
Org. levels/profil	es only on request		
		Select View(s) 📙	Default Setting 🔀



**5**. On the bottom part of the screen, the MTC's are defined per combination of 'country code' and 'tax category':

₼ . (	Change M	laterial ML	RIDIANG	600DS (	Finished Pi	roduct)
rå 🏓	Additional Dat	ta 🛃 Org. I	Levels 🚹 (	Check Scree	n Data 🔒	
Classifica	tion	Sales: sales or	rg. 1 Sale	s: sales org.	2 Sales: Ger	neral/Plant 👔 < :
Material Sales Org. Distr. Chl	MERIDIAN BE10 10		Meridian finishe Sales org BE10 Direct Sales	· · · · · · · · · · · · · · · · · · ·		áŝ р
General d	ata					
Base Unit	of Measure	PC	items	Division		01 Product Div
Sales unit				Sales u	unit not var.	
Unit of M	easure Grp					
X-distr.ch	ain status			Valid from	n	
DChain-sp	ec. status			Valid from	n	
Delivering	Plant	BEB1	BE10: B	onded ware	house	
Material G	roup	YBR05	Product	Group R05		
✓ Cash di	scount					Conditions
Tax data						
Country	Country	Tax category	Tax category		Tax classification	Tax classification 🏢
BE	Belgium	ZWST	Meridian Outp	ut Tax	1	STR Goods 🔷 🔨
CH	Switzerland	ZWST	Meridian Outp	ut Tax	1	STR Goods 🗸 🗸
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# WHERE IN SAP IS THE CTC STORED?

The CTC is stored within the customer master data view 'Sales org. data 1'. The figures below will show you the path to the CTC settings:

- Start-up transaction XD02 (change customer master data) or XD03 (display customer master data)
- 2. Fill in the customer number and the Sales Area data and 'enter':

🕞 Customer Change: Initial S	creen		×
Customer 🚹	190038		Meridian Processing Internat
Company code	BE10	Meridian BE	
Sales area			
Sales Organization	BE10	Sales org BE1	0
Distribution Channel	10	Direct Sales	
Division	01	Product Divi	sion 01
All sales areas		Custon	ner's sales areas
			✓ 6 <sup>1</sup> 6 <sup>2</sup> <sup>60</sup> ×

3. Select 'Sales Area Data'

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Schange Cus	stomer: General	Data			
C Other Customer	Company Code Data	Sales Area Data	₽		
Customer 190038	Meridian Process	sing International			
Address Control Da	ta Payment Transac	tions Marketing	Unloading Points	Export Data	Contact Person
Name					
Title	Company	~			
Name	Meridian Processing Inte	ernational			

6. Select the tab 'Billing' documents. On the bottom of the screen the CTC's are defined per combination of 'country code' and 'tax category':

7	Change C	ustome	: Sales	Area Data			
C Othe	r Customer	General [	ata	Company Code Data	a 🐔	3	
Customer Sales Org. Distr. Chanr Division	19003 BE10 nel 10 01	Sales Direct	org BE10	cessing Internation			
Sales	Shipping	Billing Doc	uments	Partner Functions			
Invoicing	invoice process	ing BE 🗇 Belgi BE Belgi	um	pate	P	rice determin.	
Delivery a	and payment te	erms					
Incoterm	ns	DDP Di	rect Deliver	у			
Terms of	fpayment	NT30 N	et due in 30	) days			
Accounti	na						
8	gmt group	01 Dom	estic Reven	iues			
Taxes							
Country	Name	Tax c	ateg Na	me	Tax	Description	
BE	Belgium	ZWST	Mei	ridian Output Tax	1	Liable for Taxes	
CH	Switzerland	ZWST	Mei	ridian Output Tax	1	Liable for Taxes	
DE	Germany	ZWST	Mei	ridian Output Tax	1	Liable for Taxes	
DK	Denmark	ZWST		ridian Output Tax	1	Liable for Taxes	
ES	Spain	ZEQT	Equ	alisation tax ES	A	Equalisation tax ES	^
ES	Spain	ZWST	Mei	ridian Output Tax	1	Liable for Taxes	~



# IS THE MTC 'SALES ORGANIZATION DEPENDENT' DATA?

The screen on which the MTC's are displayed shows the sales organization (see figure below):

v 1	Change I	Material ML	RIDIA	NGO	ODS (	Finishe	ed Pro	oduc	t)	
ൻ 🏓	Additional Da	ita 🛃 Org. I	Levels	🚰 Che	ck Screer	n Data	â			
Classifica	ation	Sales: sales or	rg. 1	Sales:	sales org.	2 Sale	es: Gene	eral/Plar	nt	<u>}</u> < :
Material Sales Org.	MERIDIA BE10		Meridian fi Sales org		Good				i	
Distr. Chl	10		Direct Sal	es					66	
General d	lata	1								
Base Unit	t of Measure	PC	items		Division			01	Produ	ict Div
Sales uni	t				Sales u	init not va	r.			
Unit of M	leasure Grp									
X-distr.ch	nain status				Valid from	n				
DChain-s	pec. status				Valid from	n				
Delivering	g Plant	BEB1	BE1	0: Bond	ded wareh	nouse				
Material (	Group	YBR05	Pro	duct Gr	oup R05					
✓ Cash d	liscount		-					Cond	ditions	
Tax data										
Country	Country	Tax category	Tax cate	gory		Tax classi	fication	Tax cla	assificat	tion 🚻
BE	Belgium	ZWST	Meridian	Output	Тах	1		STR Go	oods	^
CH	Switzerland	ZWST	Meridian	Output	Tax	1		STR Go	oods	~
< >	ш								<	>
						En	try	1	of	11

This (incorrectly) indicates that each sales organisation can define its own MTC.

This is however not true. What is displayed on the screen is misleading because the table in which this data is stored does not contain any organizational data. The table only contains:

- The material number (MATNR)
- The country code (ALAND)
- The MTC (TAXM1 u/i TAXM9)

.3	piaye	d Fields: 13 of 13		Fi	xed	Colum	ns:			3	Ĺis	t Widt	n 025
	MANDT	MATNR	ALAND	TA	XM1	TAXM2	TAXM3	TAXM4	TAXM5	TAXM6	TAXM7	TAXM8	TAXM
	100	MERIDIANGOODS	AT	1									
-	100 100	MERIDIANGOODS MERIDIANGOODS	BE BG	1 1		-							
-	100	MERIDIANGOODS	CH	1									
=	100 100	MERIDIANGOODS MERIDIANGOODS	CZ DE	1		-	-	-	_	-	-	-	

One should be aware of this, as whenever a sales organization changes its MTC for a country, it affects all other sales organizations that use this same material number!

#### Consider the following example:

Your company sells children's clothing. You have a sales organization in the UK that sells children's clothing to the UK market and a sales organization in Belgium that sells the children's clothing to the Belgium market.

All goods are manufactured, stored and shipped directly from the UK.

In the UK, children's clothing is zero rated for VAT, whereas in Belgium it is standard rated for VAT.

The MTC can be specified according to the above per country code. In the system we can therefore assign the following:

- for country code BE a MTC 'Standard rated goods'
- for country code GB a MTC 'Zero rated goods'

At first sight it looks like you won't have a problem when determining VAT for each country, but looking closer into SAP VAT determination, you discover a nasty issue with the set-up:

- The country code in the material master data represents the so called 'tax departure country'. The 'tax departure country' in SAP is defined as 'the country of the delivering plant'.
- The sales order created by the UK sales organization will be created with the delivering UK plant. As the UK delivering pant is within the UK, SAP will look up the MTC according to country code 'GB' and will correctly zero-rate the transaction for VAT.
- However the sales order created by the Belgian sales organization will also be created with the delivering UK plant. As the UK delivering pant is within the UK, SAP will again look up the MTC according to country code 'GB' and will incorrectly zero-rate the transaction for UK VAT.
- The transaction in Belgium should have determined Belgian Standard VAT rate at 21%!
- Because standard SAP will determine an incorrect tax departure country for the Belgian sales order, the MTC will be incorrect as well.

A common mistake that companies make when trying to solve this issue, is requesting the material master data team to go into the material master data, enter the sales organization and then change the MTC for country GB to 'Standard rated goods'. This is because they are under the impression that the MTC is defined per sales organization.

But, because the table in which the MTC is stored (see above) does not contain a sales organization, the master data team would in effect also change the MTC for the UK sales organization.

As a result, the next transaction performed by the UK sales organization will incorrectly determine 'Standard rated VAT', which would be incorrect.



#### A recommended approach to solve this problem is to ensure that:

- a) the system is modified to determine the correct tax departure country; and
- b) the MTC is re-determined whenever the tax departure country is changed

Within SAP note 10560 (http://service.sap.com/sap/support/notes/10560), a correction is suggested by SAP for this issue. These corrections work fine if your business flows are not too complicated.

However, within 90% of our customers we encounter various scenarios in which the tax departure country should be determined in a more flexible way.

Click here to learn more about the correct determination of the tax departure country

## IS THE CTC ALSO 'SALES ORGANIZATION DEPENDENT' DATA?

Also within the customer master data screen, it looks like the CTC is sales organization dependent data:

	<b>T</b>	Change Custo	omer: Sal	les Area Data			
	C Othe	r Customer Ge	neral Data	Company Code Data	Ł	3	
L	Customer Sales Org.	190038 BE10	Sales org BE1	Processing Internation 0			
	Distr. Chanr Division	01	Direct Sales Aroduct Divisi				
	Sales	Shipping Billin	ig Documents	Partner Functions			
	Billing do	rument					
		invoice processing dates BE	] Belgiuin Belgium	Rebate	□ P	rice determin.	
	Delivery a	and payment terms					
	Incoterm Terms of	payment NT30	Direct De Net due	livery n 30 days			
	Accounti	na					
	2	gmt group 01	Domestic Re	evenues			
	Taxes						
	Country	Name	Tax categ	Name	Tax	Description	100
	BE	Belgium	ZWST	Meridian Output Tax	1	Liable for Taxes	
	СН	Switzerland	ZWST	Meridian Output Tax	1	Liable for Taxes	
	DE	Germany	ZWST	Meridian Output Tax	1	Liable for Taxes	
	DK	Denmark	ZWST	Meridian Output Tax	1	Liable for Taxes	
	ES	Spain	ZEQT	Equalisation tax ES	A	Equalisation tax ES	^
	ES	Spain	ZWST	Meridian Output Tax	1	Liable for Taxes	~



100 0000190038 BE ZWST 1   100 0000190038 CH ZWST 1   100 0000190038 DE ZWST 1   100 0000190038 DE ZWST 1   100 0000190038 DK ZWST 1   100 0000190038 ES ZWST 1   100 0000190038 FR ZWST 1   100 0000190038 IE ZWST 1   100 0000190038 IE ZWST 1   100 0000190038 IT ZWST 1   100 0000190038 NL ZWST 1	MAND	r	KUNNR	ALAND	TATYP	TAXKD
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100 0000190038 FR ZWST 1   100 0000190038 GB ZWST 1   100 0000190038 IE ZWST 1   100 0000190038 IE ZWST 1   100 0000190038 IE ZWST 1	100	L	0000190038	DK	ZWST	1
100 0000190038 GB ZWST 1   100 0000190038 IE ZWST 1   100 0000190038 IT ZWST 1	100	L	0000190038	ES	ZWST	1
100 0000190038 IE ZWST 1 100 0000190038 IT ZWST 1	100	L	0000190038	FR	ZWST	1
100 0000190038 IT ZWST 1	100	L	0000190038	GB	ZWST	1
	100		0000190038	IE	ZWST	1
100 0000190038 NL ZWST 1	100		0000190038	IT	ZWST	1
100 0000100000 112 0101 1	100	L	0000190038	NL	ZWST	1

This, too is misleading as the table that stores the CTC's does not contain any sales organization:

Although one could assume that a custumer should always have only 1 taxable status (no matter which sales organization is selling to this customer), there are many reasons why multiple status are indeed required, even within 1 country!

#### Consider the following example:

- you are a multinational company within Germany;
- you have 3 separate legal entities;
- Legal entity A and B belong to a German VAT group ('Organschaft');
- Legal entity C however is not included in this VAT group;
- Legal entity A and C both issue intercompany invoices to legal entity B.

#### CASE 1:

An invoice from legal entity A to legal entity B should not contain VAT, as they belong to the same VAT group. To achieve this, you would like to set the CTC within the customer master data (representing legal entity B) as 'Belongs to VAT group'. This could be used to derive a specific tax treatment in the condition records.

The tax departure country (the country in which the invoice is reported for VAT) within the invoice is 'DE' (Germany).

#### CASE 2:

An invoice from legal entity C to legal entity B should contain VAT, as they do not belong to the same VAT group. To achieve this, you would like to set the CTC within the customer master data (representing legal entity B) as 'Liable for taxes'. As above, this could be used to derive a specific tax treatment in the condition records.

The tax departure country (the country in which the invoice is reported for VAT) within the invoice is 'DE' (Germany).

- **Case 1** needs to assign CTC 'Belongs to VAT group' to the customer representing legal entity B for country 'DE' (tax departure country)
- **Case 2** needs to assign CTC 'Liable for taxes' to the customer representing legal entity B for country 'DE' (tax departure country)



Within the customer master data, only 1 CTC can be assigned for country 'DE' as this data is NOT sales organization independent. Therefore, you need to choose between 'Belongs to VAT group' or 'Liable for taxes'.

Country	Name	Tax categ	Name	Tax	Description
BE	Belgium	ZWST	Meridian Output Tax	1	Liable for Taxes
СН	Switzerland	ZWST	Meridian Output Tax	1	Liable for Taxes
DE	Germany	ZWST	Meridian Output Tax	1	Liable for Taxes
DK	Denmark	ZWST	Meridian Output Tax	1	Liable for Taxes

As a result of this restriction, one of the 2 cases above cannot be handled via the customer master data and requires another solution. This could be either via a so called 'user exit' (customer specific coding) or via an additional access sequence within the VAT condition records (adding additional characteristics into the condition records).



# HOW DOES SAP DETERMINE THE VARIOUS COUNTRIES FOR THE MTC AND CTC?

As we already have seen in various examples above, within the MTC and CTC definitions on the master data, several countries are shown.

Taxes						
Country	Name	Tax categ	Name	Tax	Description	101
BE	Belgium	ZWST	Meridian Output Tax	1	Liable for Taxes	•
CH	Switzerland	ZWST	Meridian Output Tax	1	Liable for Taxes	
DE	Germany	ZWST	Meridian Output Tax	1	Liable for Taxes	
DK	Denmark	ZWST	Meridian Output Tax	1	Liable for Taxes	
ES	Spain	ZEQT	Equalisation tax ES	A	Equalisation tax ES	

These countries cannot be added manually to the master data. They are determined via a specific logic in SAP and are made available in the master data for:

- the country of the sales organisation;
- the country of the plants from which this sales organisation can deliver goods (note: these are not only the plants that BELONG to the sales organisation),

When this logic was originally designed by SAP, the determination of the countries as explained above was sufficient. But with today's business complexity, this logic is insufficient for various reasons.

#### LET'S HAVE A LOOK AT AN EXAMPLE OF DISTANCE SALES.

Your company sells children's clothing via a web shop. The UK sales organization sells children's clothing to the UK market and also (via the web shop) to the Belgium market. All goods are manufactured, stored and shipped directly from the UK. No Belgium entity / plant / warehouse exists.

In the UK, children's clothing is zero rated for VAT, whereas in Belgium it is standard rated for VAT. Normally the MTC can be specified according to a country code. But as we do not have any plant in Belgium, the system will only make the following countries available in the master data:

- The country of the sales organisation => UK
- The country of the plants from which this sales organisation can deliver goods => UK

#### In the system we can therefore only assign the following:

• for country code GB a MTC 'Zero rated goods'

As country Belgium ('BE') is not available in the system, we cannot specify for country 'BE' a MTC 'Standard rated goods'.

As a result, SAP will try to incorrectly 'zero rate' children's clothing that is sold to the Belgium market. As this issue cannot be solved within the Standard SAP master data set-up, an custom solution needs to be built into the system, for example:

- Additional access sequences to the VAT condition records (which will create high maintenance as one would need to include sales organisation and material number);
- Create a 'dummy' or 'virtual' plant in Belgium and assign this to the UK sales organization (this option is almost universally blocked by SAP solution architects);
- Create a 'user exit' (customer specific program modification) that adds additional countries into the master data.

To access more articles from Meridian detailing VAT in SAP, check out our website and click on "resources": https://www.meridianglobalservices.com/tax/technology/

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