Financial Services VAT Alert

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VAT Developments in Financial Services

Belgium: Factoring: subject to VAT, but not the "interest"

In reference to the ECJ's ruling in MKG (case C-305/01), the Belgian Minister of Finance recently confirmed that services of recourse and non-recourse factoring qualify as the collection of debts and thus are vatable with credit. However, the 'advance payments' factoring companies grant their clients in return for interest are to be viewed as a separate service consisting of the granting of loans, which is exempt without credit in Belgium (no option to tax).

Not all of the other EU Member States that are represented in the VAT Committee share the view taken by Belgium on this latest point. The EU Commission is preparing a working document to serve as "an onset guideline". This guideline is not to be expected before the year-end.

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EU: Proposal for amendment to the EC Sixth VAT Directive Submitted

The European Commission has published a proposal for a directive amending the EC Sixth VAT Directive. The proposal will allow Member States the option of adopting measures to counter avoidance and evasion in certain specific and targeted areas. In its explanatory memorandum, the Commission makes it clear that the adoption of an alternative rule would be an option and would not be mandatory. It is also made clear that while the aim is to allow Member States to counter tax evasion and avoidance, it is necessary to bear in mind the rights of taxable persons. Accordingly, the measures may only be adopted when certain conditions are met.

The proposal addresses the following aspects: grouping and transfers of going concerns, investment gold, valuation of supplies for connected parties, capital items, reverse charges, repeal of various Article 27 derogations.

Concerning the valuation of supplies, the proposal would be allowing Member States to adopt a different taxable value for supplies where the following conditions were met:

◊ the consideration for the supply is significantly lower than the open market value and the recipient of the supply does not have a full right of deduction under Article17;
◊ the consideration is significantly lower than the open market value and the supplier does not have a full right of deduction under Article 17 and the supply is subject to an exemption under Article 13;
◊ the consideration is significantly higher than the open market value and the supplier does not have a full right of deduction under Article 17.

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In addition, the option only applies when the consideration has been influenced by one of the following types of relationships: family, management, ownership, financial or legal ties (including the employer/employee relationship).

The provisions will not apply where the supplier can demonstrate that there is a commercial reason for the consideration charged or where it can be shown that a similar consideration would be charged between unconnected parties. Contrary to some speculation about the scope of this Directive, it is not a general anti-avoidance rule.

Greece: Greek Government Introduced Amendments to VAT Rates

The Government has introduced legislation amending the VAT rates in Greece with effect from 1 April 2005 as follows:

◊ Standard VAT rate: Increased from 18% to 19%;
◊ Reduced rate: Increased from 8% to 9%;
◊ Reduced rate: Increased from 4% to 4.5%

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Netherlands: Ministry of Finance Attempts to Fight VAT Saving Structures with Movable and Immovable Property

In the Budget 2005, the Ministry of Finance announced their attempt to fight 'VAT structures' using movable and immovable property. VAT saving structures for investments in movable and immovable property is considered to be undesirable by the Ministry of Finance. On April 1 a proposal to amend the Dutch VAT Act was submitted to parliament by the Ministry of Finance.

The proposal concerns (partially) VAT exempt companies and institutions such as hospitals, banks, educational institutions, insurers and certain (parts of) government bodies. The input-VAT on investments cannot be (fully) deducted by the companies and institutions and creates a debit for them. This can increase the cost-price of their investments considerably.

For these VAT exempt companies and institutions it is more favourable to structure their investments in such a way that savings on the input-VAT can be realised. All these VAT friendly structures have in common that an (affiliated) legal body invests in e.g. medical equipment on behalf of the 'exempt' institution. This body can deduct the input-VAT on the investment made and subsequently leases out the equipment for a low consideration, which is a taxable transaction for VAT purposes.

In the proposal, the State Secretary basically proposes to increase the taxable base, the consideration for a supply of goods or a service, in certain specific situations.

The Netherlands has requested the European Commission allowing to implement a derogation from the EC Sixth Directive in the Dutch VAT Act in order to fight these VAT saving structures.

The European Commission has not yet decided on the Dutch request but proposed amendments of the EC Sixth Directive to Council of the European Union itself. Part of these measures introduces anti-avoidance rules and tries to counter avoidance and evasion in certain specific and targeted areas like the VAT saving structures mentioned before. If this proposal would be adopted approval from the European Commission for derogation would no longer be necessary.

The aimed date for implementation of this proposal is July 1, 2005.

Comments
We feel, at this point, the proposed measures, in their present form, will not have the desired effect. We will keep you informed of any developments in the legislative process.

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Switzerland: VAT Treatment of Contributions from Shareholders to a Company

The Federal Tax Administration has until now had the (publicised) practice that contributions (e.g. interest free loans, a fonds perdu payments) from shareholders to their company that do not make sense from a commercial perspective are treated as donations and therefore lead to a reduction of the right to recover input VAT.

In its decision dated 11 March 2005, the Lower Tax Court has decided that the Federal Tax Administration's practice is not in line with the law and that contributions from shareholders to a company cannot lead to a reduction of the right to recover input VAT.

We expect the Federal Tax Administration to appeal against this decision at the Federal Court. However, if the Federal Court confirms this decision, it could offer interesting planning opportunities.

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United Kingdom: ECJ case - Principle of Prohibition of Abuse of Community Law Applicable for VAT?

On 7 April 2005, the Advocate-General (further: AG) released his opinion jointly in the cases Halifax (C-255/02), University of Huddersfield Higher Education Corporation (C-223/04) and BUPA Hospitals (C-419/02).

Facts
The facts in these cases are shortly outlined below.

Halifax plc
Halifax is a banking company. Halifax's supplies are generally exempt for VAT purposes and at the relevant time its VAT recovery rate was under 5%. For the purpose of its business Halifax decided to construct call centres at four different sites in which it held lease. In order to save part of the VAT cost Halifax implemented a VAT saving scheme, a sale-and-lease-back structure, involving three other companies each separately VAT-registered but, being subsidiaries, within Halifax's 'Companies Act' group.

University of Huddersfield Higher Education Corporation
The supplies provided by the university are mainly VAT exempt (education). However, a small part of supplies are taxable for VAT purposes. The pro rata was quite low. In 1995 the University decided to refurbish the East Mill and West Mill in which it had previously acquired a leasehold estate. Since the input VAT on the refurbishment costs would largely be irrecoverable if the mills were refurbished directly by the university, the university sought a way in which to save tax or to defer its liability to it.

The university opted to tax the lease of the East Mill and granted a taxable full repairing lease to a trust. In its turn the trust granted an internal repairing under lease back to the university. Properties, a wholly-owned subsidiary company of the University which was not part of the same VAT group, invoiced the university for future construction services on the mill and the refurbishment of the mill which were completed by an independent third party.

BUPA Hospitals

Per 1 January 1998 the UK law was amended in such a way that supplies of drugs and prostheses were no longer zero-rated but exempt supplies. There were no anti-forestalling provisions applicable to this new legislation. Due to previous litigation on this subject BUPA knew that the UK Government was considering implementation of this change in law.

To ensure recovery of input-VAT BUPA entered into an agreement for the prepayment of the purchase of a 100 million plus VAT-worth of drugs and prostheses in the future from company which was part of the same VAT group in 1997.

Questions referred

In each of the referred cases, it can generally be said that the basic issues are:

◊ Whether transactions entered into solely for the purposes of gaining a tax advantage qualify as supplies made in the course of economic activities?
◊ Whether the doctrine of 'abuse of rights' operates to disallow the taxpayer's right to deduct input tax?

Opinion AG Maduro

On the counter economic argument point, the AG rejected the Commissioner's view that a transaction, carried out with the sole purpose of enabling input tax to be recovered, does not constitute an economic activity within the meaning of Article 4(2) of the Sixth Directive. The AG opined that each of the transactions at issue must be considered objectively and per se. In that regard, the fact that a supply is made with the sole intention of obtaining a tax advantage is immaterial. The rejection of the counter economic activity argument is helpful for all businesses as it removes uncertainty.

On the abuse of rights point, the AG opined that a principle of abuse of rights could be applicable in the field of VAT, as a result of which, claims to deduct VAT might be disallowed where it is evident that the sole purpose of the transaction was to enable input VAT recovery. However, the adoption of a principle of prohibition of abuse of Community law is not unexpected, but that principle is applicable in very restricted circumstances. VAT planning is only going to be blocked by the principle of prohibition of abuse of Community law in circumstances where the activity is carried on in circumstances where the sole explanation for the activity is to gain a VAT advantage. In many cases, the sole explanation test will be negated by commercial rationale.

Practical implications

Businesses (that have either embraced or rejected VAT planning opportunities) may now wish to reconsider their opinion. Similarly, businesses that have received assessments or rulings based on the Halifax arguments may now wish to reconsider the validity of those rulings or assessments. It should however be noted that it is for the ECJ to decide whether to follow the AG's opinion.

We expect a final decision from the ECJ within the next 6 months. Whatever the final outcome will be, all businesses should consider the implications of the final decision with regard to how they arrange their transactions with a view to mitigating the VAT payable.

Brief analysis of the opinion

In essence, the Advocate General is proposing that a general principle of "prohibition of abuse of Community law" exists and is applicable to VAT. However, that principle is closely circumscribed and only applies to deny a taxpayer a right when there is no other explanation for the activities which give rise to that right.

Coupled with the Advocate-General's comprehensive rebuttal of the UK government's "counter economic activity" argument (i.e the argument that activities entered into solely for the purposes of gaining a tax advantage are not economic activities at all), the Advocate General appears to have confirmed that legitimate VAT planning can be entered into in circumstances where tax savings are not the sole reason why the activities are undertaken.

The Advocate General's view is that prohibition of abuse of Community law arises only where, on an objective analysis there is no other explanation for the activities undertaken. In that regard, he notes that there is no legal obligation to run a business in such a way as to maximise tax revenue for the State. However, the freedom for a taxpayer to arrange his VAT affairs in the way he chooses exists only within the scope of legal possibilities provided by the VAT regime.

The opinion also suggests that the principle of interpretation of prohibition of abuse of Community law is automatically applied by the Courts of a Member State irrespective of whether that Member State has implemented any abuse of rights domestic legislation. Furthermore, the principle applies, in the Advocate General's view, to domestic rules of Member States which implement rights conferred by Community law (which in the context of VAT includes rights conferred by the Sixth, Eighth and Thirteenth Directives).

Insofar as future VAT planning is concerned, many businesses will already have adopted the view that it is essential that any planning is only undertaken where there is some commercial purpose and substance other than the improvement of the VAT position.

This opinion, and ultimately the ECJ's ruling is likely to have wide implications across the EU. It is also likely to be the case that the amount of debates may increase, as taxpayers and tax authorities try to come to terms with the scope of the principle of prohibition of abuse of Community law, whether or not any activity is undertaken for a commercial reason as well as conferring a right, and whether any derogations from the Directive adopted by Member States are valid.

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