Recovery of incorrectly charged VAT is a recent hot topic

This newsletter highlights various items related to the recovery of incorrectly charged VAT , including the European Court of Justice's ruling on the obligations of Member States and revisions to tax authority practice in the Netherlands. In addition, we highlight some of the legal challenges of the Financial Transaction Tax, Luxembourg's planned VAT rate increase in 2015 and South Korea's latest ruling that may affect the VAT liability of global contracts.

European Union

European Court of Justice

ECJ confirms VAT time of supply for barter transactions

The European Court of Justice (ECJ) has restated the principles set out in its judgment in the earlier case of *Orfey Bulgaria* (C-549/11) that the time of supply (tax point) for each 'leg' of a barter transaction (transactions in which goods and services are exchanged between parties, sometime without any monetary compensation) are simultaneous, even though completion of one 'leg' may take place well after completion of the other.

In 2007, a group of individuals granted a building right to the taxpayer which planned to construct a building. In return for the building right, the taxpayer was to deliver to the individuals certain property situated in that building once constructed. At the time of the grant of the building right, the construction work had not been performed. In April 2009, the taxpayer charged VAT on the building services provided to the individuals. The amount of VAT charged was not determined by reference to the open market value of the property to be delivered.

The tax authority claimed that the taxable amount for this transaction was the open market value of the property to be delivered to the individuals. It also asserted that the time of supply (the time at which the VAT is due) of the construction work arose at the grant of the building right (which represented an advance payment in a barter transaction) <u>prior to</u> completion of the constrution work .

The Court considered the recent ECJ judgment in *Orfey Bulgaria* (C-549/11) as authority that the time of supply of the building right, and therefore of the delivery of the property in return for VAT purposes, were simultaneous. It further noted that valuation must be determined by the value actually received, and not by objective criteria such as market value, except in exceptional circumstances.

This case is a timely reminder to taxpayers that barter transactions often have VAT implications that should be considered and also provides greater certainty around when VAT (if any) needs to be paid. Businesses should ensure that any barter transactions (e.g., exchanges of goods and services) are tracked and reviewed from a VAT perspective.

ECJ rules on obligations of Member States to refund VAT wrongly charged

The ECJ has held that a taxpayer who has incorrectly charged VAT and paid it to the tax authority must be entitled to adjust such VAT, provided that such an adjustment does not give rise to a risk of tax loss. In this case, the tax authority had already denied the taxpayer's customer the right to recover the VAT incorrectly charged, but still sought to deny the taxpayer's attempt to reduce its output VAT liability (*Rusedespred* OOD: C-138/12).

In 2009, the taxpayer invoiced a customer for the sale and renovation of a building, itemizing the prices of the renovation works, the amounts of purchase tax and stamp duty and the amount of VAT. As the taxpayer considered the sale of the building exempt from VAT, VAT was only calculated on the price of the renovation work, purchase tax and stamp duty. The customer recovered the VAT charged on the invoice.

In 2010, the tax authority inspected the customer and refused its right to VAT recovery on the basis that all of the supplies should have been exempt from VAT. In order to correct the position, the taxpayer requested to adjust the invoice and the amount of VAT that had previously been charged. The tax authority refused the refund on the basis that the payment of the VAT had not been wrongly made. The national law and art. 203 Principal VAT Directive, provided that the VAT on the invoice was payable by the taxpayer as a person who had shown VAT on a tax invoice.

The ECJ began by stating that the art. 203 requirement for a person showing VAT on an invoice to pay it to the tax authority is not dependent on there having been an actual VAT-bearing supply. Art. 203 is intended to eliminate the tax loss risk that the right to deduct wrongly charged VAT would create. However, as the tax authority had denied the customer recovery, there was no such risk in this case.

The VAT Directive contains no provisions governing the adjustment of improperly charged VAT; therefore, the Member States must impose conditions on adjustments and make provisions for VAT wrongly charged in good faith. In order to prevent avoidance or evasion, a Member State could make adjustments conditional on the correction of an invoice, but such conditions must not undermine the neutrality of VAT, and they must not make it excessively difficult or impossible for a taxpayer to exercise the right to adjust. In the present case, the Bulgarian law permitted the taxpayer to correct the invoice but removed that ability once the tax authority had refused deduction by the customer, even though there was, as a result of the tax authority's action, no risk of tax loss. The adjustment of the invoice became impossible to exercise at that point, and that condition was, therefore, in breach of the principle of effectiveness because it went further than was necessary to prevent avoidance or evasion.

This case clarifies the boundaries within which Member States have to act when seeking to deny taxpayers the right to adjust incorrectly charged VAT. Businesses that have experienced difficulties in adjusting for VAT that has been incorrectly charged should note the outcome of this case and consider whether opportunities for corrective action now exist.

ECJ judgment in Commission v. UK and others (C-86/11)

Following the earlier Advocate-General's opinion in favor of the UK and the other Member States that allow 'non-taxable persons' to join VAT Groups, the ECJ on April 26, 2013 formally dismissed the European Commission's action and held in favor of the Member States concerned (please see January VAT Newsalert for more information).

European Union

Legal challenge to the FTT – what happens now?

As reported in the February VAT Newsalert, the European Union Finance Ministers authorized 11 of the 27 European Union Member States to proceed with the introduction of a harmonized EU Financial Transactions Tax (FTT). However, on April 18, 2013, the UK Government lodged an application at the Court of Justice of the European Union (CJEU) to challenge the EU FTT.

Although the basis of the challenge has not been made public, we understand that the UK is challenging the use of the Enhanced Cooperation Procedure (ECP) to introduce the EU FTT. Under this procedure, the European Council granted permission for the 11 interested Member States to introduce the EU FTT within those Member States.

In mounting this challenge, the UK Government voiced concerns in particular with the extra-territorial scope of the proposed EU FTT. Under the proposal, a financial institution with no presence in any of the 11 Members States could still be brought within the scope of the tax when it enters into a transaction with a counterparty in one of the 11 participating Member States, or when it enters into a transaction over a financial instrument issued in one of the 11 Member States.

It is expected that the action taken by the UK is unlikely to result in the EU FTT being derailed. That said, the difficulties emerging in the negotiations between the Members States suggest that the proposed start date of January 1, 2014 remains highly ambitious.

Institutions should continue to monitor the developments in the EU FTT proposals. By understanding, at least at a high level, the financial cost of the FTT and the drivers of that cost, an institution is better placed to pro-actively engage with governments on the EU FTT regime and to consider the strategic implications for its business model.

Denmark

New intra-EU evidential requirements from August 1, 2013

New Danish tax guidance tightens the documentary requirements for the application of VAT exemption to intra-EU sales of goods. The tightened requirements relate to cash-and-carry purchases, when the buyer collects the goods in Denmark.

For future purposes, the documentation held by the supplier must, as a minimum, contain a statement from the buyer confirming:

- the goods have been dispatched or transported
- the country of destination of the goods
- the means of transport and the relevant license number
- receipt of the goods at the address of the buyer's place of supply.

Furthermore, if deemed relevant for the transport route, the buyer is also to enclose transport documentation in the form of ferry tickets, bridge tickets, etc. In the case of cash transactions, further documentation is also required.

The Danish tax authorities have also clarified the requirement that the seller be provided with proper documentation prior to the issue of any invoice without Danish VAT. This applies to all VAT-exempt sales of goods to other EU countries, including cases not involving cash-and-carry purchases.

This clarification means that businesses will be required to charge and account for Danish VAT if they do not hold the required documentation at the time of invoicing.

The tightened rules are likely to increase the compliance burdens in Denmark, not only for Danish businesses, but also for EU businesses regularly procuring goods from Denmark. Businesses supplying or procuring goods from Denmark should confirm the documentary evidence required in order to apply exemption and implement controls to ensure efficiency in the document gathering and invoicing processes.

Germany

Introduction of entry certificate system from October 1, 2013

As reported in the November VAT Newsalert, the new German legislation for entry certificates was expected to take effect from July 1, 2013. However, the legislation was ultimately passed by the Federal Council on March 22, 2013 with some minor amendments and will take effect from October 1, 2013.

The amendments provide clarity regarding what evidence will be accepted in situations when the supplier or customer arranges for the dispatch of goods by mail, and there is no possibility of providing evidence by means of a tracking, tracing or similar protocol.

When the customer arranges for dispatch of the goods, it has also been confirmed that the evidence held must include payment of the consideration for the goods from the customer's bank account. This amendment may cause concerns in cases when consideration is not actually paid but instead set-off against payables (between affiliates, for example).

As a reminder, the new entry certificate will be the only documentation German VAT-registered businesses can use as evidence that the goods have left Germany for another EU country and thus support VAT exemption. Businesses dispatching goods from Germany should familiarize themselves with the requirements promptly in order to ensure compliance and mitigate the risk of unnecessary VAT costs.

Italy

'Omitted payment' penalty if VAT group head fails to provide bank guarantee

The Supreme Tax Court has held that, in the absence of appropriate bank guarantees supporting the VAT offsetting procedure between VAT credits and debits of companies within a VAT group, penalties for ‘omitted payments’ could be assessed.

Italy has a VAT grouping procedure under which the parent company carries out the VAT settlement on behalf of the VAT group (i.e., the VAT credits and debits of the various companies participating in the VAT group are offset) and a single payment (if required) is made by the parent company. As part of this process, it is required that the transfer to the parent company of any VAT credits and any remaining VAT group credit at the end of the year must be supported by a bank guarantee.

In the Supreme Tax Court’s decision no. 8034, of April 3, 2013, the Court held that, in the absence of the submission of a bank guarantee supporting the VAT offsetting procedure, an ‘omitted payments’ penalty amounting to 30% of the VAT due could be assessed. The Court stated that, in case a VAT credit of one company participating in a VAT group is transferred to the VAT group and offset with VAT debits of other group companies, payment of the VAT group debit is not deemed to be fulfilled if the parent company fails to provide a guarantee for the associated credited amounts.

Businesses operating VAT groups in Italy should ensure that they have the required bank guarantees in place to ensure that no penalties will be assessed.

Luxembourg

Planned VAT rate increase by 2015

The Luxembourg Prime Minister has announced a planned increase in the VAT rate by 2015. In his 'State of the Nation' speech on April 10, 2013, Luxembourg Prime Minister Jean-Claude Juncker announced that the Luxembourg standard VAT rate of 15% will rise by 2015.

Mr. Juncker explained that these changes will help counterbalance the expected loss of VAT revenues generated by e-commerce in Luxembourg. From 2015, the place of taxation of electronically-supplied services provided by EU businesses to EU private customers will shift from the country of the supplier to the country of the customer (which is expected to reduce the VAT revenues that are currently generated from Luxembourg established businesses).

The Prime Minister indicated that despite the increase, the Luxembourg government wishes to maintain the lowest standard VAT rate in the EU. Today, the second lowest standard VAT rate (18%) is applied by Cyprus and Malta (although Cyprus has already announced an increase to 19% applicable next year). Therefore, although there is no indication what the future Luxembourg rate will be, based on the Prime Minister's comments, it is unlikely to exceed 18%.

Netherlands

Reimbursement of incorrectly charged VAT can be sought directly from a business that deducted it

The Dutch Supreme Court recently published a ruling regarding the deduction of VAT that was incorrectly mentioned on an invoice. The Supreme Court ruled that there is no formal obligation on a tax inspector to issue a supplementary tax (i.e., assessment) notice to the issuer of the invoice before he can issue one to the recipient of the invoice.

Historically, the Dutch tax authorities have usually allowed deduction of VAT that was charged incorrectly, provided the issuer of the invoice pays this VAT to the tax authorities. Otherwise, the authorities can choose between seeking reimbursement of the VAT from the issuer of the invoice or from the business that incorrectly deducted it. This practice is based on a Decree stating that the tax authorities should first try to collect the VAT from the issuer of the invoice. However, this does not mean that the VAT cannot be reclaimed from the business that deducted it, especially when it is unlikely that the VAT can be collected successfully from the issuer of the invoice.

With this latest ruling, the Dutch Supreme Court has held that there is no obligation on the tax authorities to actually issue a supplementary tax assessment notice for incorrectly charged VAT to the issuer of the invoice before issuing one to the business who deducted the VAT, especially if it is clear beforehand that the issuer will not (fully) pay the VAT amount in question.

Companies conducting business in the Netherlands should be mindful of this new ruling, and should consider implementing processes and controls to ensure that VAT invoiced from suppliers was correctly charged and, therefore, can be deducted.

Slovak Republic

Removal of simplified Intrastat reporting

Effective January 1, 2013, it is no longer possible to file simplified Intrastat reports of arrivals and dispatches of goods in Slovak Republic. Therefore, businesses exceeding the Intrastat thresholds (200,000 euros for arrivals and/or 400,000 euros for dispatches) will be required to submit a full Intrastat report.

Companies filing Intrastat declarations in the Slovak Republic should review their systems and processes to ensure they capture the information required for extended Intrastat declarations.

United Kingdom

Customers can choose 'mistake of law' action to recover VAT paid in error

In a ground breaking case concerning the irrecoverable VAT suffered in breach of EU law, the UK High Court has held that the taxpayers concerned are entitled to pursue their claims against the UK tax authority, HMRC, using the 'mistake of law remedy'.

In brief, the claimants in this case had suffered VAT on investment management fees when such VAT had been incorrectly charged in breach of EU law. However, the claimants were unable to seek a full credit for the VAT charged from their suppliers.

The High Court's preliminary judgment held in summary that:

- The claimants had EU law rights to reimbursement of VAT charged in breach of EU law.
- On the facts of the case, the claimants were entitled to recover the remaining VAT directly from HMRC.
- Under UK law, the basic ingredients for a common law claim in restitution had been satisfied.
- The claims under UK law were barred by the s80(7) provision preventing common law claims but that provision had to be overridden in this case to give effect to the claimants' EU law rights.

The High Court, in this further judgment, has held that the claimants are entitled to pursue their 'mistake of law' remedy and to seek recovery of the VAT suffered directly from HMRC.

While the facts and details of this case are specific in nature, the case serves as a reminder that alternative avenues to VAT recovery can exist, particularly in cases where EU law has been breached.

Tribunal rules in favor of tax authority in 'unjust enrichment' case

In this case, despite HMRC's approval of the appellant's proposal to use a VAT refund to reduce its wider debts to HMRC, the First-tier Tribunal (FTT) held that the tax authority had no power to grant that approval. In the absence of such legally valid reimbursement arrangements, the appellant was therefore 'unjustly enriched' (*Systems Aluminum Ltd* [2013] UKFTT 201 (TC)).

The appellant in this case supplied and fitted windows and aluminum walling. It made supplies to a construction company called FM Construction Limited (FM). FM was primarily involved in the construction of new dwellings and the conversion of commercial buildings into dwellings. Therefore, it was common practice that the appellant's supplies to FM should have been zero-rated or reduced rated, but the appellant treated them as standard rated. FM eventually had financial difficulty and, at the point when it went into administration, FM owed the appellant c. £763,000. While the appellant was reviewing its claim against FM, the VAT liability error was noticed and the appellant submitted a claim to HMRC under s80 VAT Act 1994 for overpaid VAT amounting to c. £683,000.

The tax authority, HMRC, made enquiries and decided that the overpaid VAT could be repaid to the appellant. However, in September 2010, HMRC carried out a routine VAT inspection and assessed the appellant for the full amount of the refund, on the basis that it had been unjustly enriched by receiving refunds of over declared VAT without granting a corresponding credit to its customer. The appellant appealed.

In reaching its decision, the FTT considered various issues including the legal substance of the reimbursement arrangement between HMRC and the appellant and whether the appellant, by relying on HMRC's acceptance, had suffered detriment.

Ultimately, based on the facts at hand, the FTT upheld HMRC's position and required the appellant to repay the amounts previously refunded from HMRC on the basis that the appellant had been unjustly enriched. This case highlights the fact that even after refunds have been granted, there can be circumstances in which such refunds can subsequently be overturned under further audit.

Europe

Ukraine

VAT exemption does not apply to IT services

The tax office is seeking to limit the availability of VAT exemptions for the IT industry.

According to the Tax Code, an exemption from VAT applies to the supply of software products from January 1, 2013 until January 1, 2023. However, the State Tax Service of Ukraine has recently issued a clarification letter regarding the application of this tax incentive and specified that design, publishing, programming, testing, installation, implementation, and software and hardware maintenance services cannot be treated as the supply of software products.

This latest position is arguably not in compliance with the Tax Code. Businesses operating in the IT industry should evaluate the scope of the tax exemption and determine whether their services fall within the defined scope.

Asia Pacific

Australia

GST refunds – ATO's administrative treatment

Following the release last month of revised draft legislation on GST refunds, the Australian Taxation Office (ATO) has released guidance on its administrative treatment pending the passage of the legislation. The amendments, if passed, will be effective retrospectively from August 17, 2012.

The ATO has indicated that, subject to certain conditions, it will apply the existing law and follow current procedures until the proposed law is enacted.

Once the law is passed, taxpayers will need to review any claims for refunds of overpaid GST made between August 17, 2012 and enactment. However, the ATO has confirmed that if a taxpayer is required to seek an amendment to increase their GST liability, no shortfall penalties or interest will be imposed, provided the amendments are made within 28 days of enactment of the law. Appropriate interest will also be paid in relation to any amendments which reduce a taxpayer's liability.

Indonesia

Amended VAT base for certain transactions

The Ministry of Finance has amended its position regarding 'Other values regarded as VAT base' through the issuance of Regulation No 38/PMK.011/2013 (PMK 38). PMK-38, dated February 27, 2013, which has been effective since March 1, 2013.

The regulation highlights the cases in which the taxable base for VAT purposes is considered to be different from the transactional sales value. The below table provides examples of such scenarios. The latest additions are numbers 9 and 10.

No.	Event	VAT Base
1.	Own-use or free gifts and internal deliveries of taxable goods (e.g., between branches, or from the head office to branches)	Cost of sales (selling price minus gross margin)
2.	Sales of (non-inventory) assets originally not for sale and remaining inventories of taxable goods at a company's dissolution	Market value
3.	Deliveries of video and audio recording products	Average selling price
4.	Deliveries of movies	Average result per film
5.	Deliveries or imports of tobacco products	Retail selling prices
6.	Deliveries of taxable goods through an intermediary trader	Agreed price between buyer and intermediary trader
7.	Deliveries of taxable goods through an auction officer	Auction price
8.	Package shipment services, tour and tourism agency services	10% of the actual billing
9.	Deliveries of gold jewellery, including services carried out by the factory in relation to gold jewellery	20% of the selling price
10.	Deliveries of freight forwarding services in which billing includes freight charges	10% of the actual billing
No.	**Event**	**VAT Base**

Businesses engaging in the above types of supplies should assess the need to calculate VAT with respect to values different from the transactional sales price. Errors in VAT base calculation often lead to net VAT errors which can put affected businesses at risk.

South Korea

VAT treatment of supplies involving local subsidiaries

A ruling has been issued in South Korea regarding the VAT treatment of supplies involving local subsidiaries of multinational companies (Bubgyubuga 2012-410, January 10, 2013).

In brief, the ruling focuses on global contracting scenarios for networking services in which a foreign supplier utilizes a subsidiary in South Korea to provide services to South Korean subsidiaries of a foreign customer.

According to the ruling, where the South Korean subsidiary of the supplier provides services to a South Korean subsidiary of the foreign customer (under an overriding agreement between the foreign parents) and receives fees from its foreign parent in Korean Won through a foreign exchange, it may be deemed that the South Korean subsidiary provides the services directly to the South Korean subsidiary of the other foreign company. In such a case, the local South Korean subsidiary of the supplier should issue a 10% tax invoice to the domestic recipient of services.

This ruling has potentially significant implications. US multinationals engaging in global contracts involving subsidiaries in South Korea should be aware of this development. This ruling once again highlights the complexities that can arise in global contracting as VAT jurisdictions continue to implement provisions to circumvent local tax loss.

Americas

Canada

Manitoba provincial sales tax increases to 8% effective July 1, 2013

Manitoba's provincial sales tax rate will increase from 7% to 8% effective July 1, 2013, for a ten-year period ending June 30, 2023.

For the same ten-year period, the following retail sales tax rates will also increase:

- the sales tax rate on mobile, modular and ready-to-move homes, from 4% to 4.5%
- the reduced sales tax rate for electricity used by qualifying manufacturers, mining companies and oil well operators, from 1.4% to 1.6%
- the prorate vehicle tax rates (the rates varies depending on vehicle type and year of acquisition).

Effective July 1, 2013, exemption from provincial sales tax will apply to the following:

- child safety restraint systems, such as car seats and booster seats
- certain supplies for infants, including strollers, cribs, gates, monitors, and items used for nursing, feeding or bathing
- bicycle helmets (both child and adult).

Businesses operating in Manitoba should be aware of the changes and revise their systems and processes to incorporate relevant rate changes. Businesses should also assess the scope of the newly implemented exemptions to determine whether opportunities exist to reduce tax liabilities and increase profit margins.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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