EU expansion and cross border ruling potential

A significant VAT highlight this month includes the European Commission's announcement that 13 Member States have agreed to conduct a trial of cross-border VAT rulings between June 1, 2013 and December 31, 2013. In addition, the EU will gain its 28th Member State (Croatia) on July 1, 2013. In other important news, the geographical expansion of the B2V Pilot Program in China will be effective August 1, 2013 and the current scope of affected services will again be expanded.

European Union

Court of Justice of the European Union (CJEU) rules VAT remains due when deduction denied to recipient of invoice

The CJEU in *Petroma Transports SA and ors: C-271/12* held that even when deduction of VAT is denied to a recipient of a supply, in circumstances where the invoice does not evidence actual supplies, the VAT charged does not need to be refunded to the supplier.

This case concerns the VAT treatment of defective inter-company VAT invoices provided between group entities for supplies of staff (employment fees). The invoices were issued for employment contracts in which the remuneration was based on the hours worked by the particular employees. However, following an inspection, invoices were found that contained no indication of the unit price or the number of hours worked by the staff of the service-providing companies. Consequently, the tax authority denied the recipient company deduction of the VAT shown on the invoices on the basis that they were incomplete. The supplying companies provided additional information to the tax authority but that information was not sufficient to permit deduction.

The taxpayer appealed the refusal of deduction. The Tribunal, while allowing the appeal in respect of certain invoices, upheld the refusal to allow the deduction of VAT and referred the questions to the CJEU.

The CJEU held that the EU VAT Directive must be interpreted as not precluding national legislation under which the right to deduct VAT may be refused to taxpayers who are in possession of incomplete invoices, even if those invoices are supplemented by the provision of additional information after such a refusal decision has been made.

The CJEU further held that the principle of fiscal neutrality does not preclude the tax authority from refusing to refund the output VAT paid by the company providing the services in cases where the right to deduct input VAT has been denied to the companies receiving those services because of omissions from the invoices received.

This matter will be now referred back to the Belgian national courts for a final decision.

This case is one of many recent cases that demonstrates the importance of compliance with VAT invoicing rules and the powers that tax authorities possess in cases where invoicing requirements are not satisifed. Businesses should ensure ongoing familiarity and compliance with VAT invoicing requirements across the EU to mitigate the risk of unnecessary VAT costs.

Advocate-General's opinion on tour operators margin scheme infringement proceedings

The Advocate General (AG) has given her opinion in the European Commission's infringement proceedings against eight Member States in relation to their operation of the Tour Operators Margin Scheme (TOMS). The proceedings are in two parts, the first (the wholesale supply proceedings) applies to eight Member States (Spain, Portugal, France, Italy, Greece, Poland, Czech Republic, Finland) and the second (the Spanish proceedings) applies only to Spain (*Commission v France and others*: C-296/11 and Commission v Spain: C-189/11).

The TOMS is a special scheme which allows tour operators supplying services in their own name (or as undisclosed agents) to account for VAT only in the country of their establishment and only on the margin made on their services. The objective of the TOMS is to simplify VAT accounting for tour operators, while ensuring that VAT revenues associated with the travel services are allocated between the country where the travel service is enjoyed and the country in which the tour operator is established.

The wholesale supply proceedings

The eight Member States against whom proceedings were taken argue that TOMS applies equally to wholesale supplies (i.e. supplies between tour operators) as it does to supplies directly to consumers. The Commission and the remaining Member States consider that TOMS applies only when the travel services are supplied to a customer who uses the travel services. The AG considered that there was sufficient ambiguity in the wording of the EU VAT Directive to justify the interpretation of the eight member states in question, thus agreeing that TOMS should apply to wholesale supplies.

The Spanish proceedings

In the Spanish proceedings, the AG considered three specific aspects of the Spanish TOMS:

- the exclusion of the supply by retail travel agents of packages that were purchased wholesale
- the partial availability, for certain TOMS invoices, of input VAT recovery options for business customers
- the use of a global calculation, including the carry forward of losses, to calculate the tour operator’s VAT liability under TOMS.

The AG opined that all three elements were contrary to principles of the EU VAT Directive and, thus, required revision.

It is yet to be seen whether the CJEU will follow the AG's opinions. However, businesses operating in this industry should be aware that a change to the operation of the TOMS may be on the horizon for at least some countries in the EU. The EU Commission has been seeking to reform the TOMS since 2002 and the upcoming CJEU ruling may be a catalyst for such reform. The Commission has been assessing the competing and often conflicting interests of the various Member States. Hopefully, reform will move forward in line with the best interests of the industry, providing certainty and removing confusion over many fundamental aspects of a scheme that has been in place for decades.

VAT charge on deregistration to be based on residual value of assets

The CJEU has confirmed in its judgment in *Hristomor Marinov*: C-142/12 that the taxable amount for goods held at deregistration is their residual value.

As a general principle, when a taxable person ceases to carry out an economic activity but retains certain goods, the law treats the retention of these goods as a taxable supply of goods that is subject to VAT. This law exists to prevent instances whereby the final consumption of the goods, on which the VAT was previously reclaimed, remains untaxed following the deregistration of the taxable person.

In this case, the taxpayer was deregistered by the Bulgarian tax authorities and, at the time of deregistration, held cars on which input tax had previously been reclaimed. Following a VAT audit, the taxpayer was assessed for VAT on the value of those cars at an open market value at the time of deregistration. The taxpayer appealed, claiming that the depreciation of the assets since their purchase should be taken into account when determining the value for VAT assessment. The national court referred various questions to the CJEU.

The CJEU held that the Bulgarian approach of assessing the open market value of the cars at the time of deregistration was only permissible if that value corresponded with the actual residual value at the date of cessation and hence took into account depreciation of the assets since their purchase. The CJEU also noted that the purpose of the deregistration charge is to avoid a situation in which the final consumption of goods is untaxed following the cessation of economic activity and, therefore, should be applicable regardless of the cause of the cessation (i.e., whether by actual cessation of trade or simply deregistration by the tax authority).

This case is a timely reminder that the cessation of trade can result in mutliple VAT implications, which may include the liability to assess VAT in respect of stock or assets on hand at the time of such cessation. Businesses engaging in transformations, acquisitions or disposals involving the cessation of trade within group entities should ensure that all VAT liabilities are identified in order to meet compliance obligations and determine the impact of any related VAT costs.

CJEU rules Polish tax point rules incompatible with VAT Directive

In *TNT Express Worldwide* (Poland) sp. z o.o. v *Minister Finansów*(C-169/12), the CJEU held that the Polish tax point rules for supplies of certain services, including shipping and transportation, are contrary to the time of supply rules in the Principal VAT Directive.

The taxpayer in this case (TNT) is a supplier of courier, postal, transport and shipping services. TNT issued invoices to its customers on a periodic basis (weekly, monthly etc.), and accounted for the VAT due with reference to the invoice issue date. Under Polish Law, VAT is due on shipping and transport services at the earlier of the date of payment or 30 days after the services have been supplied. As a result, TNT's practices of accounting for VAT with reference to the invoice date did not align with the Polish provisions.

TNT sought a ruling to confirm its invoicing practice was acceptable. However, the Minister Finansów rejected TNT's request and ruled that VAT should be accounted for in accordance with the tax point rules under Polish law. TNT brought an action before the courts and the Polish Supreme Administrative Court sought a preliminary ruling from the CJEU.

The CJEU held that it was not possible for a Member State which opts for date of payment as the time of supply, to additionally establish a time-period (i.e., the 30 day period in Polish law) in which the tax is to become chargeable. As such, the Polish law was found to be contrary to EU Law.

This case shows the benefit of understanding the importance and variation of the time of supply rules and their implementation in the various Member States. It is unclear how Poland will respond to the CJEU's ruling; however, it is expected that a change to the current national legislation will be forthcoming.

13 Member States to conduct cross-border VAT rulings trial

The European Commission has announced that 13 Member States (the UK, Belgium, Estonia, Spain, France, Cyprus, Lithuania, Latvia, Malta, Hungary, Netherlands, Portugal and Slovenia) have agreed to conduct a trial of cross-border VAT rulings between June 1, 2013 and December 31, 2013.

Businesses engaging in cross-border transactions involving the 13 participating Member States can seek a ruling by initiating a request in the participating Member State where they are registered for VAT. Requests must be made -according to the conditions governing national VAT rulings in that Member State.

This trial program is a positive step in helping taxpayers to gain additional comfort over complex cross border trade activities. As with all rulings, appropriate consideration should be given to the approach and potential impact prior to initiating discussions.

Croatia

Croatia joins the EU on July 1, 2013

Effective July 1, 2013, Croatia will become the 28th Member State of the EU and all EU VAT obligations will apply to trade into and out of Croatia. The standard rate of VAT in Croatia will be 25%.

The VAT implications on businesses' systems and processes should be considered to ensure that any transactions in (or with) Croatia after July 1, 2013 are correctly identified for EU VAT purposes.

Areas for immediate consideration by businesses may include:

- Croatian customer records should be updated to reflect their EU VAT status, including the verification of the validity of Croatian customer VAT registration numbers, as applicable.
- Croatian invoicing requirements will now fall under EU VAT requirements.
- EU level compliance obligations (e.g., Intrastat and EC Sales List reporting) will now exist in Croatia.

Businesses should fully analyze the impact of Croatia's joining of the EU and should be aware that any interaction with Croatia will now be governed by EU VAT law.

Germany

Restriction on wholesale goods simplification on supplies to Germany

Generally, supplies of goods to business customers in other Member states are treated as zero rated intra-EU supplies of goods on the part of the supplier and intra-EU acquisitions by the customer in the Member State of arrival. In such cases, the supplier is required to check the validity of the VAT number of all customers, and customers are required to account for local acquisition VAT and satisfy various compliance obligations related to the arrival of the goods into the local market. This can often create, in particular for supplies of goods by wholesalers to many small customers, a significant additional administrative effort for both suppliers and customers.

For this reason, a simplification rule exists in Germany which allows wholesalers from other Member States to treat their supplies of goods to customers in Germany as deemed intra-EU movements of their own goods followed by a subsequent domestic supply of goods to the customers in Germany. The tax authorities in the supplier's country, as well as in Germany, have to agree on the application of the simplification rule.

This simplification allows the supplier to register for VAT in Germany and to account for local VAT on the sales to its German business customers. The benefit for the supplier is that they are not required to obtain and validate their customers' German VAT numbers. The benefit for customers is that they receive invoices with local German VAT and do not have to comply with the more onerous compliance obligations associated with intra-EU acquisitions from other EU Member States.

Germany has now restricted the application of the simplification rule by stating that the simplification will now only apply in cases where the goods arriving into Germany are transported by the supplier in its own vehicles (i.e., not via a freight forwarder or other means). A transitional period ending on September 30, 2013 has been put in place for any businesses that are operating a currently approved simplification.

Unless the new requirements are satisfied by businesses, the simplification will no longer apply and the general VAT rules for intra-EU transactions must be applied in respect of supplies into Germany. Businesses currently applying the simplification rule should consider the impact of the new rules and take the appropriate steps necessary to ensure compliance (which may include the altering of transport arrangements or, alternatively, deregistration from German VAT and fulfilment of the requirement to gather and validate customer VAT numbers).

Greece

Direct registration now possible for EU taxable persons

EU businesses that make taxable supplies in Greece may now register electronically for VAT. In short, the process involves the electronic submission of an application form to the Greek Ministry of Finance. Following submission, the tax office will check the validity of the submitted information through VAT Information Exchange System (VIES) and, if approved, issue a VAT registration certificate.

EU businesses may now also submit Greek VAT returns electronically. The EU taxable person should register with the electronic services of the Greek Ministry of Finance to submit returns electronically.

The purpose of the new electronic processes is to speed up VAT registration and simplify Greek compliance for EU businesses. It is unclear whether electronic registration will be rolled out to non-EU businesses.

Recovery of VAT on balance sheet: Update on the current framework and the expected advancements

In accordance with the current legal framework and the practice of the Greek tax authorities, businesses applying for a VAT refund should be audited before the VAT refund is actually granted.

The statute of limitations for obtaining the VAT refund is 3.5 years from the date of filing the VAT refund claim. In cases where the tax administration does not perform the tax audit within the 3.5 years, the right for a VAT reclaim becomes time barred and the VAT refund can be lost.

Following various instances of time barred VAT claims, the Greek Ministry of Finance is now considering introducing rules to accelerate and grant VAT refunds to companies within a period of 3 to 4 months. Currently, the Greek Ministry of Finance is assessing the situation; therefore, we cannot yet predict when these new rules will become effective.

Businesses should monitor the VAT refund deadline in Greece and pro-actively appeal or write to the tax authorities promptly if the VAT audit has not begun or if the VAT claim has not been refunded. Litigation may even be considered in cases where the VAT refund claim lapsed because of the failure of the Greek tax authorities to carry out an audit.

Italy

New obligation to issue electronic invoices to public bodies

On May 22, 2013, the Italian Economic and Finance Minister published Decree no. 55/2013 concerning a new obligation to issue electronic invoices in respect of supplies made to public bodies. The new rules will be introduced in two stages, the first in June 2014 and the second in June 2015.

In June 2014, businesses that supply to Italian Ministries, the Italian Tax Agency, and national social security and welfare entities must issue electronic invoices. Effective June 2015, businesses that supply to all other public bodies (except local public bodies) must issue electronic invoices.

The requirements applicable to electronic invoices issued to public bodies will be more stringent than general e-invoicing requirements. For example, invoices should have an .xml (extensive markup language) format, be endorsed with a qualified or digital electronic signature, and must be transmitted through an interchange data system that will be made available by the public body itself, or via an authorized intermediary. Invoices must also contain specific data related to the public entity involved (a unique code assigned to the public office and to the supplier), the number of the contract, and other data such as transport documents and payment details.

Electronic archiving is mandatory for electronic invoices. Therefore, suppliers issuing such invoices to public bodies will have to use storage mediums and processes with appropriate features, such as qualified electronic signatures and timestamp tokens, in order to fulfill their e-archiving obligations.

Once the new rules take effect, the public bodies will not proceed with payment if any other invoice other than an electronic invoice that meets the criteria above is received. It is therefore imperative that affected businesses are ready for these changes and ensure they implement systems and process capabilities to issue and receive e-invoices as required.

United Kingdom

Tax authority comments on VAT treatment of pension's advisory services

The recently published Revenue & Customs Brief 09/13 sets out the tax authority, Her Majesty Revenue & Custom's (HMRC's), views on the VAT liability of pensions advisory services and charges, and the associated recovery of such VAT by employers.

In summary, HMRC's view is that the supply of advice and other services in relation to the setting up and ongoing administration of Group Personal Pension (GPP) plans is subject to VAT. However, HMRC consider that such VAT may, in some cases, be recoverable by the participating employers provided that a valid VAT invoice is issued to the employers directly (irrespective of the fact that payment may be made by the pension operator).

HMRC consider that the VAT treatment of pension advisory services provided directly to employees will depend upon the nature of the services provided. However, in principle, they expect that any VAT chargeable in respect of such services is unlikely to be recoverable.

The VAT implications of pension services and the recovery of VAT incurred during the operation of pension schemes has been the subject of various cases and tax authority briefs in recent years. Employers, pension funds and their advisers should ensure they are compliant with the rules and guidance applicable to their particular circumstance, while also ensuring that VAT recovery is maximized.

VAT rate increases: EU, Europe and Middle East

Slovenia

VAT rate to increase from 20% to 22% effective July 1, 2013

From July 1, 2013, the standard VAT rate will increase from 20% to 22% and the reduced rate from 8.5% to 9.5%.

Montenegro

Proposed increase in VAT rate to 19% effective July 1, 2013

The Government has officially determined that the standard VAT rate should be increased from 17% to 19%. The increase is subject to Parliamentary approval and is due to take effect July 1, 2013.

Israel

VAT rate increase to 18% effective June 2, 2013

From June 2, 2013, the VAT rate increased from 17% to 18%.

As with all VAT rate changes, businesses should take appropriate steps to update their systems, contracts and pricing to account for the new rates. In addition, careful attention should be taken to ensure that supplies spanning the rate change are subjected to the correct VAT rate in accordance with the various transitional rules.

Asia Pacific

Australia

High Court backs Tax Commissioner in landmark avoidance case

In the first GST general anti-avoidance matter to be considered by the High Court of Australia, the Court in the matter of *The Commissioner of Taxation v Unit Trend Services Pty Ltd* [2013] HCA allowed an appeal by the Commissioner of Taxation (Commissioner) in relation to the application of the GST general anti-avoidance rules (GAAR).

This case concerned a residential property development arrangement under which land was partially developed by one entity and then sold as a GST-free going concern to a related entity which was also a member of the same GST group. The completed apartments were then sold to end purchasers under the GST margin scheme (a scheme under which GST is only levied on the profit margin attributable to the sale). The relevant margin was greatly reduced as a result of the inter-company transfers and, thus, resulted in a significant reduction in GST liability.

The taxpayer argued that the GST benefit was attributable to its choice to apply the margin scheme and therefore, that the anti-avoidance rules did not apply. However, the Court found the GST benefit did not arise as a consequence of this statutory choice but rather as a result of a commercial decision to transfer the property between associated entities. Therefore, the Court held that the GST benefit obtained was attributable to the wider arrangement, and was precluded by the application of the GAAR.

This is the first time the High Court has provided a ruling on the application of the Australian GAAR that gives taxpayers greater clarity over how the provisions may be applied. This decision also serves as a general reminder of the global existence of anti-avoidance provisions which can apply to certain commercial arrangements that, although permitted by law, focus on obtaining a VAT/GST benefit.

China

Get ready for the nationwide implementation of B2V Pilot Program

From August 1, 2013, the business tax (BT) to VAT transformational pilot program (B2V Pilot Program) will be expanded nationwide.

While the scope of the pilot program is still confined to the existing pilot industries of transportation and certain ‘modern services’, the definition of modern services will now be expanded to include the production, broadcasting and distribution of media and cinematic productions. The railroad transportation, postal and telecommunications industries are also expected to be added in due course. We also expect that construction, real estate and financial services will be among the next group of focus industries to be targeted by the Pilot program.

China’s aim is still to complete the B2V Pilot Program within the five year period of 2011 to 2015 (inclusive). This latest expansion represents another clear milestone in the transformation process.

Companies in China should continue to stay up to date with the ongoing changes, determining the impact on their business to ensure compliance and efficiency as the program expands further.

Clamping down on false invoicing and fraudulent export refund claims

In conjunction with the expansion of the B2V Pilot Program, the Chinese Authorities have announced a special program designed to restrict instances of false invoicing and fraudulent export refund claims.

Under this program, it is anticipated the tax authorities will increase their audit of VAT taxpayers to ensure a high level of compliance. It has already been reported that the Dalian tax authorities have mounted a VAT audit program resulting in increased VAT audits in 2012 and have recovered significant increase in assessments for back taxes and late payment penalties.

While the B2V Pilot Program translates into lower costs for the majority of businesses, it also leads to lower tax revenues for the Chinese government. Therefore, it is not surprising that the tax authorities are taking increased steps to enforce the legislation and prevent fraud. Good documentation will be critical to withstanding challenges from the increasing and more stringent VAT investigations by both the state and local level tax authorities. Enterprises should also consider strengthening their internal controls and building a stronger foundation geared towards more systematic VAT compliance.

Indonesia

New duty and VAT exemption for oil and gas exploration

Effective April 2, 2013, the import of goods for oil and gas exploration and exploitation activities are eligible for import duty, VAT and LST (Luxury Sales Tax) exemption. These exemptions have been provided with the aim of boosting the increase in domestic oil and gas production in Indonesia.

The introduction of the exemptions should reduce the administrative burden and costs associated with the import of such goods into Indonesia. Businesses operating in this sector should ensure they take advantage of the new provisions.

Americas

Mexico

Guidance on withholding VAT from foreign residents without a Mexican PE

The Mexican Tax Authorities recently published guidance for Mexican taxpayers that are acquiring or leasing tangible goods in Mexico from foreign residents with no Permanent Establishment (PE) in Mexico. The guidance establishes that Mexican taxpayers are required to consider the definition of PE as set out in the Mexican

Income Tax Law in order to determine whether VAT should be withheld in respect of such acquisitions or leases.

When a Mexican taxpayer purchases or leases tangible goods supplied by foreign suppliers without a PE in Mexico, obligations may exist for the Mexican taxpayer to withhold VAT from the payment to those suppliers. The purpose of this latest tax authority guidance is to clarify for taxpayers that the meaning of PE for VAT withholding purposes should be considered with reference to Mexican income tax law and not with reference to the VAT residency status of the supplier as provided for under Mexican VAT law.

Given the interaction, and potential for confusion, between the income and VAT legislation, it is possible that some Mexican taxpayers may have determined their liability to withhold VAT with reference to the VAT residency status of their suppliers as opposed to the PE position of their suppliers as laid down in income tax law. In such cases, the taxpayers may not have withheld the appropriate amount of VAT.

Mexican taxpayers acquiring or leasing goods from foreign entities should review their position and ensure compliance with the latest guidance. US entities supplying or leasing goods into Mexico should also be aware of this clarification, and determine whether any of their supplies could be impacted by the VAT withholding rules.

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