

VAT rate changes on the horizon



This month's edition of VAT News highlights the Advocate General's opinion on the VAT treatment of a US head office's services to its Swedish branch that is part of a Swedish VAT group, VAT rate changes proposed in Luxembourg, Poland and Crimea and the potential introduction of Japanese Consumption Tax on electronic supplies of services by foreign enterprises to Japanese customers.

Court of Justice of the European Union(CJEU)

Advocate General opines that a Swedish branch of a US parent should not be registered as a member of a Swedish VAT group

The Advocate General ('AG') opined in the matter of *Skandia America Corporation USA* (C-7/13) that services supplied within a Swedish VAT group should be taxed in Sweden, even though the services were acquired in the US by a US parent and supplied by a Swedish branch of the US parent.

Skandia America Corporation USA ('Skandia'), a Swedish branch of a US parent, consumed software and software maintenance services acquired by its US parent company. The Swedish branch is registered for VAT in Sweden as a member of a VAT group. Typically, supplies between a head office and its branch are not subject to VAT. In addition, the supply of most goods and services between VAT group members are disregarded for VAT purposes.

The costs of the services consumed by the branch were reallocated at cost +5% for transfer pricing purposes. The Swedish branch, through its local resources, supplies such services to members of the VAT group. The Swedish tax authority registered the US

entity as a non-established taxable person and made an assessment for output VAT due on the supply of the services.

On appeal, the Swedish court decided to refer the following questions to the CJEU for a preliminary ruling:

- Do supplies of externally purchased services from a company's main establishment in a third country (in this case the US) to its branch in an EU country (in this case Sweden), with an allocation of costs for the purchase to the branch, constitute transactions subject to VAT if the branch belongs to a local VAT group?
- If the answer to the first question is yes, is the purchaser of the services required to self-account for VAT on a reverse charge basis when the supplier (i.e., the US company) is not established in the same country as the purchaser?

The main question submitted to the CJEU was whether the allocation of the externally purchased services constituted a transaction subject to VAT. However, the AG commented on the interpretation of the VAT grouping provisions in Article 11 of EU VAT Directive 2006/112, stating such provisions permit EU countries to regard, as a single taxable person, any persons established in the territory of that EU country that are closely bound to one another by financial, economic or organizational links. In his view, the notion of 'person' referred to in these provisions can only be understood in its ordinary sense (i.e., literally a 'being', a person with a legal personality). Consequently, an entity must be a distinct 'person' to join a VAT group. The AG did not consider the branch a distinct 'person'. A principal establishment and its branch, as part of the same legal person, cannot be separate taxable persons for VAT purposes and taxed differently.

In summary, the AG opined that the decision of the Swedish authorities to accept the branch as a member of the local VAT group, without treating the entire company as a member, is incompatible with the VAT grouping provisions. The AG also discussed four explanations based on his observations, as follows:

- a. The branch could be excluded from the VAT group. As a result, the supplies from the branch to the Swedish members of the group would be subject to Swedish VAT, due by Skandia to the tax authority.
- b. The branch and its head office could be included in the VAT group. In that case, the services purchased from the third party that are allocated to the Swedish VAT group member would be subject to a reverse charge of Swedish VAT (the VAT group would be liable), if the third party supplier is not established in Sweden.
- c. Membership of a VAT group is voluntary in Sweden; therefore, Skandia could decide to exit the VAT group if the CJEU decides the branch cannot be a member without its main establishment. Under this scenario, the same outcome as under option (a) above would apply.
- d. Sweden could invoke the anti-abuse provision of the VAT grouping provisions. If the Swedish authorities could not exclude the branch from the group under domestic law, they could take necessary measures to avoid non-taxation. The transactions between the head office and the branch would be considered as taxable and the tax would be due by the VAT group as the recipient of the services.

All four alternatives would result in VAT being accounted for either by Skandia or the VAT group. However, the AG rejected the argument that the branch became a different taxable person from the non-EU establishment by becoming a member of a VAT group.

The AG also suggested an alternative answer to the questions referred, in the event that the opinion on VAT grouping should be rejected. The AG stated that the VAT group should be treated as the recipient of the third party services allocated to it, and

the Swedish VAT group should account for Swedish VAT on the value of the services on a reverse charge basis.

If the CJEU follows the opinion of the AG, the impact of the judgment could be very significant. Various EU countries have introduced a VAT group regime in local legislation. Each country's legislation has specific features and most countries do not apply VAT to cost allocations, such as those considered in Skandia's case. The AG did not take a final position on the alternative outcomes. However, the CJEU may come to a more definitive decision.

While this case only deals with externally purchased services, aforementioned option (a), the AG's proposal could also lead to the taxation of internal costs. However, option (b) may not necessarily have the same effect. Businesses with international branch structures that use VAT grouping provisions should consider the impact on current VAT accounting if the CJEU follows the AG's opinion.

European Union

Ten EU member states to introduce Financial Transaction Tax ('FTT') by 2016

At a recent Economic and Financial Affairs Council (ECOFIN) meeting, council members agreed that the proposed Financial Transaction Tax ('FTT') would be finalized by 2016. Participating EU member states agreed to a step-by-step approach to apply the EU FTT to certain derivative and stock transactions. The following ten EU member states agreed to the introduction of FTT by 2016: Belgium, Germany, Spain, France, Italy, Austria, Portugal, and Slovakia. Slovenia, one of the original countries in favor of the tax, opted to refrain from signing the joint agreement.

The UK Government recently lost an appeal against the implementation of FTT in the CJEU. The CJEU considered the UK Government's decision to challenge the proposed FTT premature since the tax is not yet in operation and no details have been published.

The EU countries that will introduce the tax in 2016 have not indicated which instruments will fall under the definition of stocks and derivatives, nor have they indicated the FTT rates to be charged. Businesses that deal in financial instruments in these EU countries should monitor the developments of FTT closely given the additional potential indirect tax costs.

Luxembourg

Confirmation of VAT rate increase to 17% effective January 1, 2015

The Prime Minister confirmed a decision by the government to increase the standard VAT rate by two percentage points from 15% to 17%, effective January 1, 2015. The 12% intermediate rate will also increase by two percentage points to 14% and the reduced rate from 6% to 8%. The super-reduced 3% rate that applies to food items, among others, will not be changed, but will likely be reviewed as applied to real estate related transactions. Businesses currently registered for VAT should be aware of the upcoming rates changes and ensure ERP systems are updated accordingly.

Poland

VAT rate to decrease in 2016

Poland's Finance Minister announced that the government intends to lower the VAT rate from 23% to 22% by 2016, a year earlier than originally planned. Businesses currently registered for VAT should be aware of the upcoming rates changes and ensure ERP systems are updated accordingly.

Europe

Ukraine

VAT rate in Crimea reduced to 4%

The State Council of Crimea has established new taxation guidelines on the peninsula. VAT taxation rules include the following further significant changes, effective from May 1, 2014 until January 1, 2015:

- In Crimea, the regular rate is now 4%, and the reduced rate for groceries, goods for children, periodicals, medical goods, etc. is now 2%. The 20% VAT rate applies prior to May 1, 2014.
- During this period, Crimean taxpayers are not entitled to credit input VAT paid to Ukrainian and Russian suppliers. Ukrainian input VAT incurred before May 1, 2014 should be recoverable.

Effectively, these changes mean that VAT is transformed into turnover tax in Crimea. In addition to VAT taxation, the guidelines also affect excise taxation, taxation of individuals, and certain tax administration procedures.

Asia Pacific

China

Chinese telecom carriers will be included in the VAT pilot program as of June 1, 2014

Effective June 1, 2014, China's VAT pilot program ('B2V reform') will be expanded to the telecommunications industry. Telecommunications services are currently subject to a single rate of tax under the business tax (BT) regime. After the B2V reform, two rates of VAT will apply to telecommunications services: 11% for 'basic services' and 6% for 'value added' services. According to Circular 43, basic services and value added services can be distinguished as follows:

- Basic services include voice services via telecommunications infrastructure and the transfer or assignment of the right to use bandwidth, wavelength, or network of any nature.
- Value added telecommunications services include the supply of SMS (short message services) and MMS (multimedia message services) through telecommunications infrastructure, the transmission or application of the digital data and information, and access to internet and satellite television signal ground transfer services.

Telecommunications services are commonly bundled with free gifts such as phone cards or telephone sets. Under Circular 43, the price elements of the bundled package sale should be separately identified, and VAT should be imposed on each element at the appropriate rate (e.g., 17% for the sale of goods, 6% for the sale of 'value added' services and 11% for the sale of 'basis' telecommunications services).

Businesses within the telecommunications industry, along with related businesses, should review business contracts, since this transition to the new VAT system may have an effect on the commercial pricing arrangements between a supplier of telecommunications services and its customers. In addition, telecommunications companies should consider whether current reporting systems are capable of correctly accounting for VAT due on such telecommunications services.

Japan

Taxation of imported e-services from October 1, 2015

The Ministry of Finance recently submitted a proposal to the International Taxation Discussion Group of the Government Tax Commission on the possibility of levying Japanese Consumption Tax ('JCT') on electronic supplies of services by foreign businesses. These new rules would apply to foreign electronic supplies of books,

music, software, applications, etc., effective October 1, 2015. Businesses supplying electronic services into Japan should be aware of these developments.

Let's talk

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



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