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# *Noteworthy VAT developments regarding EU cross border transactions*

This edition of VAT News highlights the European Court of Justice's (ECJ) decision on the VAT treatment of intra-EU supplies of goods subject to final processing in the EU country of destination, a new ECJ decision on the interpretation of fixed establishments, an update regarding the EU cross-border ruling project, and the extension of the reverse charge applicable to supplies of electronic devices in certain EU Member States.

## *European Court of Justice*

### *The ECJ held that the place of supply of goods transported from Italy to France for final processing and onward sale is France*

This case concerns transactions between an Italian company (Fonderie 2A) and its customer in France. Goods were shipped from the supplier in Italy to France. In France, a third party received delivery of the goods and carried out some minor processing services on behalf of Fonderie 2A (primarily painting work). The goods were then sent to the end customer (also in France) in a finished state. Fonderie 2A treated its sale as taking place from Italy and applied to the French tax authorities under the 8th Directive procedure for a refund of the VAT charged to it by the third party processor.

Notably, the transactions in question took place in 2001. Following the 2010 'VAT Package' changes, B2B supplies of 'work on goods' are now taxable where the customer is established (art 44 Principal VAT Directive). In this case, no local VAT was charged by the

processor and the customer was liable to account for the VAT due under the reverse charge procedure.

The French tax authorities refused the refund request on the basis that Fonderie 2A had made a supply of the finished goods in France, thus rendering it ineligible under the 8th Directive refund rules. In the course of subsequent proceedings, the Conseil d'État decided to stay proceedings and refer the following question to the ECJ for a preliminary ruling:

> "Do the provisions of the Sixth Directive [77/388/EEC] for defining the place of an intra-Community supply mean that the supply of goods by a company to a customer in another country of the European Union, after the goods have, on the vendor's behalf, undergone processing at the place of business of another company in the country of the customer is a supply between the country of the vendor and the country of the final recipient or a supply within the territory of the country of the final recipient, from the place of business of the processor?"

Following the Advocate-General's opinion, the ECJ considered that the supplier should be considered to have made a sale in the destination country (France) and not an intra-EU sale from the dispatch country (Italy). The ECJ gave the following answer to the question referred:

> "Article 8(1)(a) of Sixth Council Directive 77/388/EEC ..., must be interpreted as meaning that the place of supply of goods sold by a company established in a Member State to a person established in another Member State, and on which the vendor, to make them fit to be supplied, has had finishing work carried out by a service provider established in that other Member State, before having them dispatched by the service provider to the person to whom they are being supplied, must be deemed to be in the Member State where the latter is established."

In similar sales, suppliers may be subject to additional VAT registration and compliance liabilities in the country of processing and customers may have cash flow impacts. Whether or not a company's position changes following this case will depend on the contractual arrangements, the scope of the processing and the number of EU countries involved. Companies involved in cross-border processing should analyze the impact of this case in more detail.

### *ECJ rules on 'fixed establishment' of supply recipient*

The ECJ held that the principles established in EU case law concerning the supplier's place of establishment for VAT purposes under art 9(1) Sixth VAT Directive apply equally to the recipient's place of establishment under art 44 Principal VAT Directive, and irrespective of whether the supplier and recipient are independent of each other.

The taxpayer in this case is a Polish company, Welmory sp zoo (WP). Welmory Limited (WC), an associated company established in Cyprus, organizes sales by auction on an online sales platform. It also sells packages of 'bids' i.e., the right to make an offer to purchase the goods being auctioned for a higher price than the previous bid. WC signed a cooperation agreement with WP in 2009 to provide WP an Internet auction site with a Polish domain name along with associated services relating to the leasing of the servers for the site and the display of the goods to be auctioned. WP principally sold its goods on that site.

For the period from January to April 2010, WP issued four invoices for advertising, servicing, provision of information and data processing supplied to WC. WP considered those services supplied at the place of establishment of WC in Cyprus, and subject to VAT in Cyprus under the reverse charge mechanism. Therefore, WP did not account for Polish VAT.

However, the tax authority considered that WP's supplies of services were made to a fixed establishment of WC in Poland and that they should be taxed in Poland at the

standard rate. The Supreme Administrative Court, uncertain about the interpretation of art 44 of the Principal VAT Directive, decided to refer the following question to the ECJ for a preliminary ruling:

> "For the purposes of the taxation of services supplied by company A, which is established in Poland, to company B, which is established in another Member State of the European Union, in circumstances where company B carries out its economic activity by making use of company A's infrastructure, is the fixed establishment within the meaning of Article 44 of Council Directive 2006/112/EC situated in the place in which company A is established?"

Principles established in the ECJ's earlier case law concerning art 9(1) Sixth VAT Directive still apply in the context of art 44 Principal VAT Directive, which determine place of supply according to the location of the recipient rather than the supplier. Both articles were intended to avoid conflicts of jurisdiction and non-taxation, and the wording and objectives of the two were similar.

The case law on art 9(1) established that the primary point of reference for determining the place of supply of services for tax purposes is the place where the taxable person has established his business. If that place of business does not lead to a rational result or creates a conflict with another Member State, another establishment may be considered. The same principle applies to the interpretation of art 44 but applies to the place of the recipient of the supply rather than to the supplier.

The case law also established that a fixed establishment must be characterized by a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to receive and use the services supplied to it for its own needs. To be regarded as having a fixed establishment in Poland, WC would be required to have, in Poland, at the very least a structure with a sufficient degree of permanence, suitable in terms of human and technical resources to enable it to receive in Poland the services supplied by WP and use them for its business of operating the online auction system and selling 'bids'.

The fact that such a business could conceivably be carried on without human and material resources in Poland is not determinative. Also, the facts that the economic activities of the two companies were linked by the cooperation agreement, formed an economic whole, and essentially supplied the needs of consumers in Poland, were not material to determining whether WC had a fixed establishment in Poland. The services supplied by WP to WC and by WC to consumers in Poland were distinct supplies of services and subject to different schemes of VAT.

The ECJ concluded the following in answer to the referred question:

> "A first taxable person who has established his business in one Member State, and receives services supplied by a second taxable person established in another Member State, must be regarded as having a 'fixed establishment' within the meaning of Article 44 of Council Directive 2006/112/EC ..., in that other Member State, for the purpose of determining the place of taxation of those services, if that establishment is characterized by a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to receive the services supplied to it and use them for its business, which is for the referring court to ascertain."

Businesses with global contracts engaged in transactions involving various customer establishments should consider this decision when determining the correct VAT treatment of their supplies.

## *European Union*

### *Update on the EU cross-border ruling initiative*

As reported in the June 2013 VAT News , several EU Member States (currently 15) within the framework of the EU VAT Forum have agreed to participate in a test case

for private VAT ruling requests relating to cross-border situations. As part of the agreement, taxable persons planning cross-border transactions between two or more of the participating Member States (Belgium, Estonia, Spain, France, Cyprus, Lithuania, Latvia, Malta, Hungary, Netherlands, Portugal, Slovenia, Finland, Sweden and the United Kingdom) can ask for such a ruling with regard to the anticipated transactions.

The EU VAT Forum made a first evaluation of the VAT cross-border rulings pilot in May 2014. National tax authorities and businesses favor extending the initiative to other EU Member States and also continuing this initiative beyond 2014. Moreover, the participants agreed on a voluntary basis to the publication of the cross-border rulings.

A few rulings were published and address questions such as the VAT treatment of events, supplies of SIM cards for mobile phones, and supplies of parts (tyres) that are to be assembled to a main product (machinery) when the parts are first delivered in-country to the supplier of the main product and then shipped together with the main product to the customer in another EU country.

The initiative is scheduled to last until the end of 2014 and then be reassessed. This initiative can be an efficient option for businesses with complex cross border transactions in the EU to obtain more certainty with regard to the VAT treatment of their activities and can help mitigate related risks.

## *Reverse charge for supply of electronic devices in Germany, Poland and Spain*

In order to deal with the missing-trader or carrousel fraud, EU Member States continue to adopt the reverse charge mechanism for domestic supplies of specific goods and tradable services, including electronic devices.

*Germany*

In Germany, the reverse charge procedure is currently already in place for supplies of mobile phones and certain integrated circuits if the total consideration for such goods sold in the range of a single economical transaction is at least EUR 5,000. Beginning October 1, 2014, the reverse charge procedure was extended to the supply of tablet computers and game consoles. Initially, no official definition in the German law for 'tablet computers' and 'game consoles' existed, which created practical difficulties. In response, the Finance Ministry decreed that the reverse charge applies to any mobile device capable of being used as a mobile phone on a public network. In principle this means that any device with a SIM card, or with a SIM card slot, that can output a message received as an audible signal meets the definition. Devices which cannot be used as telephones continue to be subject to mainstream VAT.

*Poland*

In Poland, similar amendments become effective January 1, 2015. The reverse charge mechanism applies to the supply of mobile phones (including smartphones), mobile computers (tablets, notebooks, laptops, etc.) and game consoles. The new rules will apply to transactions exceeding a daily threshold of PLN 20 000 (about US$6,000) for a particular purchaser, and in some cases PLN 10 000 (about US$3,000). The manufacturers and distributors of mobile devices are required to:

- monitor the daily value of the supplies to particular purchasers
- document supplies in a different way than previously
- present transactions covered by the reverse charge mechanism in recapitulative statements submitted on a monthly basis to the tax office.

In addition, purchasers are responsible for proper output VAT settlement on purchases and the corresponding risks.

*Spain*

In Spain, also effective January 1, 2015, the reverse charge mechanism will apply to supplies of mobile phones, video game consoles, laptop computers, and digital tablets. Suppliers and customers of relevant mobile devices in these countries should consider their new liabilities and adapt their VAT accounting and compliance accordingly.

### *Denmark*

#### *Tax authorities focus on non-established e-commerce*

A recent survey provided to the tax authorities states that an estimated £300 million of annual VAT is not being accounted for by non-established e-commerce in relation to their business to customer (B2C) supplies of goods to the Danish market. The Danish Tax Authorities (SKAT) announced that a key focus area in 2015 will be to ensure that non-established e-commerce account for Danish VAT on B2C sales of goods to the Danish market.

Based on the announcement, we expect the tax authorities will monitor non-established e-commerce in the beginning of 2015 to ensure that Danish VAT is accounted for on relevant B2C sales. Along with the audit risk, suppliers of non-established e-commerce should also consider the challenges of making a retrospective recharge of VAT to a B2C customer. Additionally, please be aware that the threshold for distance sales in Denmark is EUR 35,000.

All non-established e-commerce providers making B2C supplies of goods to the Danish market should assess their Danish VAT position. A prompt voluntary disclosure to the authorities in respect of any unsettled VAT may prevent the authorities from imposing penalties or assessments for more than the three previous years. Conversely, penalties could be imposed in an audit in cases in which the non-established trader has been aware of an obligation to register and account for Danish VAT, with risk of the periods for assessment extending as far back as the previous ten years.

### *Belgium*

#### *Reverse charge penalties applicable where no loss of VAT*

A recent case from the Brussels Court of Appeal demonstrates how expensive it can be for businesses that do not apply the reverse charge and thereby do not self-account for the VAT due on incoming invoices. The Court of Appeal held that proportional penalties were applicable when the reverse-charged VAT was fully deductible by the company liable for applying the reverse charge.

Belgium applies a 200% penalty, automatically reduced to 20% in absence of any fraudulent intent. If the reverse charge VAT is fully deductible, the penalties apply, but the interest is generally waived.

In practice, the penalty often applies even when no VAT loss occurred. Courts are now confirming the position taken by the VAT authorities. Companies liable for self-assessing VAT on transactions in Belgium (including in relation to various adjustments) should be aware of the potential risks to ensure compliance with their VAT obligations.

## *Asia Pacific*

### *China*

#### *B2V reform of insurance sector in 2015*

As previously reported, since 2012 China has been gradually rolling out the VAT pilot programme for various service sectors to transform the business tax (BT) to a VAT system (B2V) by the end of 2015. The insurance sector, with its complex and significant transactions, was expected among the last of the industries to be included

in the B2V transformation. Although insurance sector B2V reform is unlikely in 2014, reform is expected by the end of 2015.

### *Japan*

#### *Update on planned taxation of cross-border digital supplies*

The implementation date for the previously reported reform of Japanese Consumption Tax (JCT) to tax imported digital supplies is still currently unknown. Some aspects of the planned reform appear controversial. The following noteworthy issues have been identified in connection with the reformed rules:

- **Japanese residency.** According to the Cabinet Office website, "Confirmation of Japanese residency by the customer's credit card number and the invoice's addressee will be respected." However, uncertainty arises when a customer's credit card number and the invoice's addressee are registered outside Japan, but the customer resides in Japan, and vice versa.
- **Business-to-business (B2B) transactions.** If businesses purchase items that, by their nature, are ordinarily sold to consumers, or are sold to both consumers and businesses but are not clearly B2B transactions, input JCT thereon may be blocked (irrecoverable).
- **Hospital purchases of e-books.** If hospitals buy electronic books, input JCT thereon will be blocked (irrecoverable) in proportion to their non-taxable sales ratio (for insured medical services).

In addition, according to the Cabinet Office website, the following two types of transactions will be exempt:

- Services of information gathering, summarizing, analyzing etc. of a foreign country, rendered outside Japan (including reporting of results). For example, a fee paid by a Japanese financial institution to a foreign law firm for e-mail reporting of a target company's information for mergers and acquisition activity outside Japan.
- Services of buying, managing, or selling assets located in a foreign country, rendered outside Japan (including reporting of results). For example, a fee paid by a Japanese company to a foreign financial institution for investment in foreign stocks and bonds, outside Japan and for e-mail reporting of the result.

Further detailed guidelines should be forthcoming.

## *Americas*

### *Mexico*

#### *Accelerated VAT refunds for fixed asset investments*

On September 25, 2014, the Tax Administration Service (SAT) published an amendments draft (fifth resolution) of the Fiscal Miscellaneous resolution for 2014, which includes a measure to accelerate the return of VAT credit balances generated by fixed asset investment projects.

Under the draft amendment, taxpayers participating in fixed asset investment projects may obtain repayment of VAT credit balances generated by the implementation of such projects. Qualifying investment projects include the acquisition or production of goods, including the supply of services or the temporary use of goods related to the acquisition or production of the assets. VAT credit repayment will be made within a maximum period of 20 working days from the date of the request submission, subject to certain requirements such as:

- The creditable VAT related to the investments represents at least 50% of the total creditable VAT declaration.

- The credit balance requested exceeds $ 1,000,000.
- The acquisitions correspond to new goods purchased or imported permanently, as from January 2014, and are permanently used.
- Payment of costs that generate the creditable VAT has been made by check, credit card, debit, or services or electronic funds transfer.

The first refund application will be resolved in a regular period of 40 working days, and subsequent applications within 20 working days. However, the refund may be denied in certain cases, such as:

- taxpayers that have signatures or unsecured tax credits which cannot be located for Tax ID purposes
- taxpayers that have committed fraud or have non-existent transactions supported by fiscal invoices, or cancelled certificates of electronic signatures.

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## *Let's talk*

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