



## INDIRECT TAX UPDATE

APRIL 2016

## European Commission presents Action Plan on VAT

The much publicised, and long awaited European Commission Action Plan on VAT has been released. The Commission intends to modernise the current VAT rules and eliminate certain flaws of the VAT system, such as vulnerability to fraud and complexity when it comes to cross-border trade.

The key measures proposed are as follows.

- A future single EU VAT area – cross-border transactions would be treated in the same way as domestic transactions.
  - VAT would be charged under the rules of the originating country on sales that are made across borders to another country in the EU, at the rate applicable in the country of consumption.
  - The VAT on a cross-border sale (goods or services) would be collected by the tax authority of the originating country, and transferred to the country where the goods or services are ultimately consumed.
  - The One Stop Shop would be extended initially to cover 'business to business' ('B2B') supplies of goods.
  - Transitional arrangements would allow 'trustworthy businesses that are certified by their tax administrations' to initially continue to purchase goods free of VAT in another Member State and pay VAT in their own country (ie temporary continuance of 'reverse charge').

Subject to agreement by all parties, a legislative proposal will be submitted by the Commission in 2017.

- Actions to combat VAT fraud – outline of expected timings for planned initiatives in this area are:
  - 2016 – measures to improve cooperation between tax administrations and with customs and law enforcement bodies and to strengthen tax administrations' capacity;
  - 2016 – evaluation report of the Directive on the mutual assistance for the recovery of tax debts;
  - 2017 – proposal to enhance VAT administrative cooperation; and
  - 2017 – proposal for the definitive VAT system for cross-border trade (single European VAT area, see above).
- VAT rates – the Commission's proposals to modernise the framework and give greater flexibility to Member States regarding reduced VAT rates are:

### Option 1:

- extension and regular review of existing reduced rates provided for by the EU's Principal VAT Directive ('PVD');
- extended to all Member States to ensure equal treatment;
- pre-agreed authorisations known as derogations (e.g. zero rates) already legally applied in Member States would be maintained;
- minimum standard VAT rate of 15% would be maintained;
- Member States would not be able to introduce completely new zero rates.

### Option 2:

- abolish reduced rates;
- adopt the principle that Member States are free to follow the reduced rates policy they wish – provided such does not generate tax distortions;
- introduction of safeguards to avoid unfair competition and to prevent fraud – eg limits on the number of different rates that Member States could adopt, and a prohibition on reduced rates for easily transportable, high value items;

- Member States would have to continue to abide by general Single Market and competition rules.
- existing reduced rates, including derogations (e.g. zero rates) already legally applied in Member States would be maintained,
- the minimum standard VAT rate would be removed.

Subject to agreement by all parties, a legislative proposal will be submitted by the Commission in 2017

- Digital Single Market – the proposals will aim to:
  - extend the current single web portal concept (One Stop Shop mechanism) to EU and non-EU sales of tangible goods to final consumers ('B2C') – the seller would be able to declare and pay all VAT for both domestic and EU sales in its own Member State and the tax authority then transfers VAT revenues to other Member States where VAT is due.
  - introduce a VAT-free threshold to help start-ups and microbusinesses;
  - ensure that businesses are audited only by the tax administration of their home country;
  - remove the VAT exemption that applies for the import of small consignments from suppliers in third countries;
  - address the unequal VAT treatment of paper versus e-publications and attempt to align VAT rates policy for e-publications across the EU.

### What this means

This is the pan-EU action plan heralded in the UK Budget as affording the UK the ability to apply VAT at the zero-rate to sanitary products, and continue to afford VAT at the reduced-rate to solar panels and other energy-saving materials (both currently charged at 5% in the UK).

While the Action Plan certainly addresses the opportunity for Member States to agree to the extension and regular review of existing reduced rates, or even to abolish the list of existing reduced rates and implement and follow the reduced rate policy they wish, the overarching aim is to put in place a definitive VAT system which would not only make it 'simpler' for businesses to use, but would also reduce cross-border VAT fraud.

The EU estimates that, as a result of weaknesses in the current VAT system, and the way in which it is administered across the EU, cross-border VAT fraud alone accounts for EUR 50 billion of revenue lost each year.

To address this, the EU therefore seeks to improve co-operation between Member States' tax authorities by affording Eurofisc – a network of national civil servants set up for the rapid exchange of targeted information on VAT fraud – direct access to relevant information held in different Member States; a sort of 'country-by-country' reporting by tax authorities.

Businesses will also be required to play their part. Under current EU VAT accounting rules, a company in Country A can sell goods to a company in Country B without VAT being added, the company in country B accounts for VAT and pays this over to the treasury of Country B when the product has been sold on.

The EU's proposal for a 'single EU VAT area' aims to treat cross-border the same way as domestic transactions, resulting in significant changes regarding accounting and reporting for B2B supplies.

Replacing the current 'VAT-free' intra-EU model, the Action Plan envisages the company in member state A applying member state B's VAT rate, and paying this over to the tax authorities in member state A. The One-Stop-Shop currently being applied to B2C e-services will therefore have to be adapted to accommodate B2B supplies of goods and services.

The EU considers that this change alone should help reduce cross-border VAT fraud by EURO 40 billion per year. Given that the budget of the European Communities is financed wholly from the Communities' own resources – which includes a uniform rate 0.30 per cent of a member state's VAT revenues – it should therefore come as no surprise that the European Commission considers that 'it is time for the creation of a genuine single EU VAT area for the single market'.

## UK

### Holding companies

The Upper Tribunal of the UK Courts has dismissed the appeal of the taxpayer in the Norseman Gold plc case, finding that 'management services' provided to the company's Australian subsidiaries did not amount to the making of any taxable supplies that gave the right to recover VAT on costs.

Key to the Tribunal's decision was that, at the time the input tax was incurred, Norseman could not provide evidence that management services were being provided or would be provided, nor could it establish any direct and immediate link between any services that were supplied and charges levied or to be levied.

Although the Tribunal agreed with the an earlier decision that 'management services' could, in principle, be treated as an economic activity, the fact that the provision of management services for what was essentially a fixed fee based on what the subsidiary could afford to pay meant the activity did not constitute a taxable business activity. The failure to agree on, or stipulate any price or consideration for the supplies, could, in the view of the Tribunal, only lead to the conclusion that there was no obligation to pay for the supplies at the time they were made, thus no reciprocity of obligation; the 'management services' could not therefore constitute a taxable supply that could enable recovery of input VAT incurred on underlying costs.

### What this means

There is a long standing issue about the VAT treatment of holding companies and particularly the extent to which they carry out activities for VAT purposes that enable them to register for VAT and recover VAT on professional fees e.g. deal costs. This ruling takes the issue further in suggesting that the value of management charges is important in that it must be set on a commercial figure, rather than being a purely arbitrary figure based, for example, on the subsidiary's ability to pay.

It remains to be seen whether the company will appeal the decision in this case, and whilst we do know that the UK tax authority HMRC intends to issue updated guidance on recovery of VAT incurred by holding companies following the earlier Courts of Justice of the European Union ('CJEU') decision of Larentia + Minerva, one would expect the Norseman Gold decision to play a role in this forthcoming guidance.

Careful consideration will be required of the treatment of VAT incurred on deal fees incurred in corporate finance transactions resulting in the creation of a holding company to, for example, acquire a business as they will be likely to be held in close scrutiny.

### VAT representatives and security

The recent Budget Statement in the UK announced the enactment (in the Finance Bill 2016) of new provisions as part of a package of measures aimed particularly at overseas businesses selling goods (located in the UK at the time of sale) to UK consumers, mainly via online marketplace. HMRC will have the power to direct that a taxable person, whose business is not established in the EU, to appoint a UK VAT representative, who would be jointly responsible, along with the overseas business, for the payment of its VAT liability.

### What this means

This is the latest weapon of the UK government in the high profile fight against tax avoidance, given the prevalence and significant growth of such online sales. It should be noted however, that in line with professional bodies' guidance RSM UK's policy is not to take on the fiscal responsibilities of a 'tax representative' for a 'non-established taxable person'.

[Andy Ilsley, RSM UK](#)



## BELGIUM

### **Abuse of distance selling rules**

The Belgian VAT administration has published a policy change to stop abuse of distance sales rules sometimes applied by online sellers. The threshold for distance sales to Belgium is 35.000 EUR. To apply distance sales the seller must be responsible for the shipment of the products. Under such arrangements, upon completion of the online purchase, the website of the online seller would typically divert the buyer to the website of a separate transport company and it is the buyer that arranges and pays for the transport.

In that case the rules for distance sales do not apply and the seller can charge VAT at the rate in his home state irrespective of whether the distance selling threshold for Belgium would otherwise be exceeded. In most cases the local rate is lower than that applying in Belgium and as a consequence Belgian online sellers are disadvantaged by the practice.

This abuse is no longer possible on the basis of a publication on the Belgian tax authorities website dated 9 February 2016. The new rule states that if the seller is directly or indirectly involved in the transport of the products (and the distance sales threshold of 35.000 EUR has been exceeded), Belgian VAT (standard rate 21%) is due and the seller is required to register for VAT in Belgium.

### **What this means**

The Belgian authorities have acted decisively to prevent further abuse of the distance selling regulations and this is further indication of the potential for significant VAT leakage with the continued growth of the digital economy.

### **VAT on directors' fees**

Individual directors of companies that raise charges for their services do not charge VAT (Belgium considers that the director is not acting for the company of which he or she is a director, but separate to it). The VAT authorities had already announced (in 2014) that directors acting through a company would be required to charge VAT on their fees although there is currently an optional regime (in place since 1993) whereby companies can consider their charges as not subject to VAT.

Under proposed rules to make such VAT charges compulsory, where the business in which the directors are appointed cannot (fully) recover input VAT, the new regime will generate a VAT cost (insurance companies, real estate, banking, non-profit organisations, hospitals, etc.) a number of concerns have been raised by businesses. For this reason the VAT authorities have further postponed the effective date for this legislation. It is now set on 1 June 2016.

### **What this means**

The VAT authorities have repeatedly promised to publish a VAT notice with further details although this is not yet forthcoming. For example there is an indication that the tax authorities would accept requests for the directors and the companies they represent to be put in a VAT group as part of a wide review of the VAT grouping requirements.

This is of particular relevance to partly exempt companies and will also effect Belgian directors of overseas companies. We will provide updates in due course.

[Gonda Schelfhaut, RSM Belgium](#)



## NETHERLANDS

### **Dutch VAT exemption on services linked to sports and physical education incorrectly applied**

The European Commission has successfully challenged a Dutch VAT exemption for hiring of quays and moorings before the CJEU, arguing that the exemption for 'services closely linked to sports and physical education' as described the PVD was not correctly implemented.

Under the Dutch VAT Act, a VAT exemption based on the PVD was available for hiring of quays and moorings to members of a non-profit making water sports association, regardless of whether the vessels were actually used for sports or recreational use.

The EC accused the Netherlands of not correctly implementing the exemption provided for in the PVD correctly, because:

1. The exemption is too broad, in the sense that the Dutch exemption granted an exemption for hiring of quays and moorings for vessels used for recreational purposes, whereas the Directive requires a close link of these activities with sports or physical education.
2. The exemption is too limited, in the sense that the exemption unjustly limits the scope of the exemption by adding a second condition to the non-profit character of the organisation, requiring that the association does not make use of any staff in employment with the association.

The CJEU ruled against the NL, stating that :

1. The exemptions provided for in the Directive require a strict reading. Therefore, services that are not closely linked to sport or physical education, but are offered for recreational or even residential use cannot fall under the exemption.
2. Any conditions attaching to exemption must be in line with the PVD. Thus, an additional condition that the water sports associations should not make use of any employed staff is not acceptable.

### **What this means**

The judgement has confirmed once and for all that the Netherlands has imposed VAT exemption incorrectly and will be required to amend its legislation, both limiting the scope to usage linked to sports or physical education and by expanding the scope to all organisations of a non-profit character.

The impact of this change could have wider ramifications to other areas of sport and physical activity where the income may have wrongly been treated as exempt. It will be interesting to see whether any such changes are retrospective as it may present an opportunity to make claims for VAT wrongly paid over on income, or, if VAT exemption has been wrongly applied, additional claims to input tax for example on capital projects.

[Liesbeth de Groot, RSM Netherlands](#)



## OTHER INDIRECT TAX NEWS

### Extension of VAT system in China

Whilst China has had a VAT system since 1994, it has only been applicable to supplies of goods and supplies of specifically defined services connected with the processing, production, repair and replacement of goods. Activities not subject to VAT have generally been subject to Business Tax ('BT'). The Ministry of Finance and State Administration of Taxation in China has announced that, from 1 May 2016, VAT will be comprehensively extended to replace BT.

This widespread reform brings a raft of new business sectors within the scope of VAT. Despite the tight time limits between the detailed announcement and the implementation date, businesses and business investors must ensure that they are ready for the changes.

#### What this means

The key industry sectors affected are real estate, construction, financial and insurance services and lifestyle services, which includes medical and healthcare, education, food and beverage, hospitality and entertainment.

In the past, affected businesses have been subject to relatively straightforward flat rates of BT. The new VAT system introduces a range of rates and methods of calculation. It will mean:

- identifying and addressing the financial and administrative impact of the changes;
- revising business systems, invoicing and contracts; and,
- training personnel to deal with the changes.

Dealing effectively with the transition from BT to VAT will reduce risk, improve compliance and address cash and cashflow issues.

#### Businesses outside China supplying qualifying services to chinese business customers

In general, a business with no establishment in China which undertakes taxable activities in China will not be able to register and account for VAT in China.

However, China has adopted a procedure by which the Chinese customer which receives qualifying services acts as withholding agent.

Under this arrangement, the invoiced value is treated as including any VAT due in China. Subject to local provisions, the Chinese customer may be able to recover this VAT.

As the arrangement can result in non-resident suppliers of qualifying services actually being paid less than the invoiced value of the services, VAT can represent a serious cost issue for suppliers and customers. Businesses which are potentially affected must discuss the position with their Chinese customer to assess whether the VAT charge will be neutral or there is a VAT cost risk.

[Peter Chen and Flame Zheng, RSM China](#)

For further information please email [internationaltax@rsmi.com](mailto:internationaltax@rsmi.com) to be put in touch with your local tax expert.

**RSM Global Executive Office**  
50 Cannon St  
London  
EC4N 6JJ  
United Kingdom

T: +44 (0)20 76011080  
E: [internationaltax@rsmi.com](mailto:internationaltax@rsmi.com)

**[www.rsm.global/insights/tax-news](http://www.rsm.global/insights/tax-news)**

RSM is the brand used by a network of independent accounting and consulting firms, each of which practices in its own right. The network is not itself a separate legal entity of any description in any jurisdiction.

The network is administered by RSM International Limited, a company registered in England and Wales (company number 4040598) whose registered office is at 50 Cannon St, London EC4N 6JJ.

The brand and trademark RSM and other intellectual property rights used by members of the network are owned by RSM International Association, an association governed by article 60 et seq of the Civil Code of Switzerland whose seat is in Zug.

© RSM International Association, 2016

