INDIRECT TAX UPDATE

JULY 2016

UK

Post referendum 'Brexit'

The news in the UK (and globally for that matter) has been, and will continue to be in the weeks, months and indeed years to come, dominated by the recent UK referendum vote to leave the European Union (so called 'Brexit'), and the resulting political and economic fall-out. Given the UK's VAT system intrinsically tied in with EU membership, and the reimposition of imports and exports to and from the EU, indirect taxes are potentially subject to the greatest impact in the post-Brexit world.

The UK's VAT and Customs relationship with the EU going forward will, of course, be the subject of extensive negotiations, with an initial two year period commencing when Article 50 of the Lisbon Treaty is invoked – this being the formal agreed 'trigger point' for a Member State wishing to leave the EU and thereby commencing the terms of its exit. In the intervening period, businesses will want to understand the impact of potential scenarios both on current business operations and long term strategic plans. It is important to note, however, that currently, and indeed throughout the Article 50 negotiation period, the UK remains a full member of the EU and therefore the Principal VAT Directive ('PVD') and the Union Customs Code ('UCC') will continue to apply.

What this means

Although Brexit represents uncharted territory in many respects, there are number of agreements in place/under negotiation with the EU. The models adopted by Norway, Switzerland, Turkey and Canada, together with existing WTO agreements, provide valuable insights into what the UK might be able to negotiate from a VAT and Customs perspective, allowing businesses based in, or trading extensively with the UK, to start assessing the impact of a range of scenarios on:

- Pricing and competitiveness – the amount of VAT or duty payable due to changes in rates, liability, place of supply or access to reliefs;
- Cashflow – changes to the speed at which VAT and duty costs can be reclaimed or deferred;
- Administration – the impact of expanding import/export procedures and setting up systems to establish the origin of goods etc.;
- Systems – the robustness of existing systems and the ability to identify transactions affected by the Brexit changes and to adapt the VAT determination; and
- UK and EU compliance obligations – changes in registrations or filing procedures, access to refund procedures and simplifications.

We will be monitoring developments closely.

Recovery of input tax – Letters of Engagement

The Supreme Court in the UK has recently confirmed that even if a taxpayer is a signatory to an engagement letter and it has the sole obligation to pay the service provider's fees, then that does not necessarily mean that it has an entitlement to recover the VAT on those fees.

The Court was considering the appeal of Airtours which, in 2002, ran into financial difficulties. Professional advisors were commissioned by a number of financial institutions to ascertain whether Airtours' proposed refinancing was viable. The dispute relates to Airtours' right to recover the VAT it paid to professional advisors under the terms of a 'tri-partite' agreement between Airtours, the professional advisors and Airtours' lenders.

Having determined that the contracts (Letters of Engagement and Terms & Conditions) were not artificial in nature, and did, in fact, reflect the economic reality of the arrangements, the Supreme Court determined in a majority ruling that the only supply was from the professional advisors to the financial institutions. This is on the grounds that the professional advisors' services were used by the lenders, not Airtours.

What this means

The judgment of the Supreme Court demonstrates the importance of giving due consideration to the recovery on costs especially when it may be argued that the services or goods in question are not received by the company paying for the supply. All factors should be included in this thought process, including; the contracting parties, the services being supplied and the terms of the engagement letter.

Any businesses which are likely to incur what are usually not insignificant amounts of VAT on fees in relation to corporate activity, including acquisitions or re-financing costs need to consider the VAT position at the outset and give proper consideration to the VAT aspects.

Andy Ilsley, RSM UK

GERMANY

The Court of Justice of the European Union ('CJEU') has provided a preliminary ruling in the case of Wolfgang und Dr. Wilfried Rey Grundstücksgemeinschaft GbR regarding a change in partial exemption recovery methods introduced by the German tax authorities following a taxpayer's initial deduction of input tax using the standard-based turnover method of apportionment.

The facts in the case are that a property partnership demolished an old building and constructed a new building on the site containing both commercial and residential units, such that income generated from lettings was a mixture of standard-rated and VAT-exempt. The taxpayer calculated its entitlement to deduct VAT paid on associated costs by applying a turnover-based pro-rata calculation, which was accepted by the tax authorities. Subsequently, when the intended use of the building changed, the taxpayer made an adjustment to the VAT claimed again using the turnover-based calculation. However, in the meantime, German VAT legislation was amended so as to provide that the turnover-based method of apportionment should only be used if no other method were possible or more precise. The German tax authorities considered that a floor area-based method should have been used, resulting in a lower VAT recovery rate than that provided by the turnover-based method. The CJEU was asked to rule on whether this could be permitted by EU VAT law.

The CJEU has ruled that the introduction of a floor-based calculation for recovery of input tax incurred in a mixed-use development may be more appropriate than the previous 'standard' turnover-based method if such a method provides 'a more precise determination of the deductible proportion' – that does not mean however that the method chosen must necessarily be the most precise possible.

What this means

This case serves as a reminder that where a business has a mixture of income that is subject to VAT and VAT exempt, care must be taken to ensure that the method of calculating VAT recovery on overhead costs results in the fairest and most reasonable method of recovery. It may not necessarily be so, with a value-based recovery method although often that represents the most practical and 'easy to operate' method.

Intra-community supplies of goods – whether VAT number essential for zero-rating

In advance of a ruling by the CJEU, the Advocate General has given his opinion that supplies of goods from one EU member state to a business customer in another (intra-community supply) can still be zero-rated (VAT exempt, but with a right of recovery of input tax) even if the VAT registration number of the customer is not quoted.

In the case in question, a German entity bought a new car for business purposes which was then transferred to Spain for subsequent sale. As the entity was not registered for VAT in Spain, the recipient could not provide a Spanish VAT registration number. The tax office therefore refused to grant zero-rating in respect of the intra-community transfer.

The Advocate General has concluded that the PVD should be interpreted as allowing the tax authority of the Member State of origin to accept zero-rating in respect of an intra-Community transfer even where the customer has not provided an overseas VAT registration number, provided that there is no specific evidence of tax evasion, the goods have evidentially been moved to another Member State and also other conditions of the zero-rating are met.

What this means

The Advocate General's Opinion does seem to suggest that intra-community transactions can be treated as zero-rated without quoting the customer's VAT number but only in very exceptional circumstances and only where objective evidence indicates removal from the country of dispatch and receipt by the business customer in the country of arrival. The Advocate General based his opinion basically on three facts of the case – there being no evidence of tax evasion, the fact that the goods had been evidentially moved to another Member State and the fulfilment of all other conditions.

It remains to be seen whether and to what extent the CLEU will follow the Advocate General's Opinion – but it does represent a further indication of the desire of the EU to ensure VAT is declared and accounted for where goods end up, rather from where they are when sold.

Oliver Ehrmann, RSM Germany

NORWAY

Streamlines VAT Registration For Non-Residents

Foreign companies in Norway will be given the option to choose whether or not to register through a VAT representative under amendments to the VAT Act proposed by the Government. In a recently published statement, the Government has said that the proposed changes are designed to streamline the VAT registration process and therefore reduce administrative costs for non-resident businesses making taxable supplies in Norway.

What this means

Under Norway's current VAT rules, companies without a permanent establishment in Norway but making taxable supplies there of more than NOK50,000 (USD5,400) per year must register for VAT. Currently it is compulsory for them to use a local representative in order to do this. However, the Government intends to abolish this requirement and instead allow non-resident businesses to choose whether they want to register through a local VAT representative. The new rules would apply to companies established in member states of the European Union or the European Economic Area.

Claus Petter Moe, RSM Norway

HUNGARY

Changes in the administrative requirements in Hungary

Currently, businesses registered in Hungary are required to provide additional information on invoices with a VAT value of at least 1,000,000 HUF. This results in compliance obligations for both the Hungarian supplier issuing the invoice and the customer receiving it if it is seeking VAT recovery in respect of the transaction in question and separate listings need to be prepared. However from 1 January 2017 the threshold will be reduced to 100,000 HUF

What this means

The significant reduction in the threshold means that many more businesses will be impacted and therefore will need to be comfortable that the additional compliance requirements are met and that the necessary systems changes required are adopted

According to the proposal, all invoices issued by a taxpayer registered in Hungary which include at least 100 000 HUF VAT will have to be included in the issuer's summary statement ('M sheet'). On the purchaser's side, all taxpayers registered in Hungary accepting an invoice which include at least 100 000 HUF VAT, will have to include this invoice in their summary statement if they are to recover VAT on the basis of this invoice.

New requirements for invoicing software

Alongside the changes in the obligation to provide a summary statement, the requirements regarding invoicing software will also change according to the new government proposal.

Businesses issuing invoices quoting a Hungarian VAT number have been, since 2014, required to inform the authorities as to which invoicing software they use. The invoicing software used must comply with strict requirements such as sequential numbering of the invoices, etc. Failure to use the appropriate software and failure to report it results in administrative penalty of up to EUR 1700.

From 2016 the invoicing software must also be capable of collecting data in pre-defined format to the Hungarian Tax Authority in the event of a tax or VAT audit. The Hungarian Tax Authority has issued a detailed guidance on how the standard accounting file (SAF) should look like, more specifically which fields should be reported and how.

Furthermore, businesses issuing invoices using an approved invoicing software will be required to provide real time data in respect of these invoices. The real time date provision must include all transactions in with other tax registered Hungarian businesses and where the invoice shows an amount of at least 100 000 HUF VAT.

The new real time data providing requirement will be introduced in two steps. As the first step from 1 January 2017 (as a test phase) it will be optional to provide the additional data. The system will go live and the new requirement will become mandatory from 1 July 2017.

The new requirement assumes additional IT development in terms of the invoicing software used by the taxpayers issuing invoices. Since the invoicing software is supposed to be able to provide data for the Tax Authority if required from 1 January 2016, the new requirement should not put an excessive administrative burden onto taxpayers.

What this means

If businesses are already obliged to hand in summary statements at present, the only change in this respect will be that more data will need to be included on these sheets. If businesses have issued, or received invoices with at least 100,000 HUF VAT, but less than 1,000,000 HUF VAT, summary statements ("M" sheets) will be required as part of the VAT declaration and therefore the additional compliance burden will need to be considered.

"Not for profit" companies were carrying on an economic activity – CJEU judgment

The CJEU has issued a judgment in the Hungarian case of Lajvér Meliorációs Nonprofit Kft. and Lajvér Csapadékvízrendezési Nonprofit Kft., which concerned the recovery of VAT on the cost of the construction and operation of a water disposal system. The project was largely funded by national and EU aid and the two "not for profit" companies involved planned to charge only "modest" fees for the use of the system.

The Hungarian tax authority decided that the companies were not carrying on an "economic activity" and rejected the VAT claims made by them. The CJEU disagreed. It decided that the construction and operation of the works amounted to "economic activity". It also commented that "... the fact that the price paid for an economic transaction is higher or lower than the cost price, and, therefore, higher or lower than the open market value, is irrelevant for the purpose of establishing whether it was a transaction effected for consideration ...".

It was left to the Kúria (the Supreme Court in Hungary) to determine whether there were any factors that broke the link between the charges made and the use of the system, and whether the transaction at issue in the case is a wholly artificial arrangement which does not reflect economic reality and was set up with the sole aim of obtaining a tax advantage.

What this means

This is an important judgement from which 'not for profit' entities can take heart. It reinforces the important principle that the charges set for services provided need not be at a commercial level or even designed to cover costs, in order for the activity to be regarded as 'economic' and therefore providing an entitlement to input tax recovery. However, see the CJEU ruling in the Dutch Borsele case below – any charges do need to represent more than nominal contributions that are, for example, based on the recipient's ability to pay rather than on objective factors.

Daniel Sztanko, RSM Hungary

NETHERLANDS

No economic activity for a local authority providing transport services

Recently the CJEU has ruled in the case of Gemeente Borsele that a local authority providing services for transporting schoolchildren under certain conditions – and charging a fee based on the income of the parents – did not carry out an economic activity and does therefore not qualify as a 'taxable person' for VAT purposes. This meant that the VAT on the costs involved for subcontracting the transport companies was not recoverable.

The municipality of Borsele acquired the services of transport companies for eligible pupils to transfer them to and from school. One third of the parents of pupils for whom school transport was provided paid contributions, equivalent to 3% of the amount paid by that municipality to fund school transport services, totalling to less than EUR 14.000. The difference was financed by the municipality from public funds.

The municipality of Borsele claimed to be a taxable person for the purposes of VAT in respect of the provision of school transport services in return for payment of contributions by the parents and was thus entitled to recover the VAT that had been charged by transport companies. The claim was rejected on the ground that the municipality did not provide services for consideration and therefore did not carry out any economic activity.

The CJEU ruled that the municipality of Borsele was not a 'taxable person' under the PVD. In order to determine whether a service is supplied 'in return for consideration' (and thus within the scope of VAT) all the circumstances in which it is supplied have to be examined. The amounts received by the municipality was no more than indicative of a supply for VAT purposes but not, in itself, determinative.

Because there was such a vast difference between the operating costs and the sums received in return for the services offered, the parental contribution had to be regarded more as a public fee than as consideration for an economic activity. It therefore followed that there was no genuine link between the amount paid by the municipality to the transport companies in question and the contributions made by parents for the service to be regarded as an economic activity.

What this means

Whilst, as confirmed in the Lajvér case, the charges set do not have to be at a commercial rate, nor even make a profit, they must be more than nominal nor merely based on one's ability to pay. That in itself is insufficient to make a link between the payment and a service being provided in return

Liesbeth de Groot, RSM Netherlands

RUSSIA

New E-commerce rules in Russia

A draft Federal Law has recently passed through its third reading by the State Duma to amend the current VAT rules for electronically supplies services, for example sale of database rights, software, games, music, books, video products by foreign companies to Russian private consumers in order to ensure that there is no competitive disadvantage to Russian providers of such services over those from overseas.

Under the current rules it is more advantageous for Russian private customers to buy such content from foreign companies and escape the VAT that Russian providers would be obliged to charge and therefore be placed at a competitive disadvantage.

Overseas providers of electronic services to Russian customers will be obliged to register for VAT from the date of effect of the amended provisions, 1 January 2017.

What this means

Russia has moved to amend its legislation in this area, largely to mirror that applicable in the EU from 2003 to require non EU businesses to register and charge VAT on such services to EU private recipients to prevent them competing with EU businesses. The EU further extended these provisions in 2015 to ensure that VAT is paid in all cases in the country where the customer resides.

This approach now being similarly adopted in Russia ensures equal conditions for domestic and foreign companies selling content to end consumers, thereby removing the tax advantages for foreign companies, including those located in low-tax or tax-free jurisdictions.

Businesses providing electronically supplied services to Russian customers should note the legislative changes and take action now to ensure that its compliance obligations are met to enable Russian VAT to be charged where appropriate.

Evgeniya Voroshilina, RSM Russia

EUROPEAN UNION

EU VAT rules on the treatment of vouchers

The EU Council has adopted an amendment to the PVD which defines single-purpose vouchers or 'SPVs' (i.e. those where the transaction for which the voucher can be redeemed is known at the time the voucher is sold) and multi-purpose vouchers – MPV's - (which can be redeemed for a number of goods and services potentially attracting different VAT liabilities), sets rules to determine the taxable value of transactions in both and provides, broadly, for VAT to be charged at the point of issue for single-purpose vouchers and on redemption for multi-purpose vouchers. These new rules will only apply to vouchers issued after 31 December 2018. Narrower in scope than the Commission's earlier 2012 proposals, the directive does not cover discount vouchers.

What this means

The proposed changes recognise the current complexity and inconsistency regarding the taxation of vouchers within the EU and will hopefully lead to less complexity and instances of double or non taxation.

The timing of this is interesting, from a UK perspective at least, given the UK's vote to leave the EU (and therefore to no longer be bound by Directives such as this going forward). The date of 1 January 2019 from when it would be effective is likely to be when the UK is well on the way towards negotiating the terms of its 'Brexit'. Notwithstanding that, we would expect the UK to fully endores and implement the proposed changes, given that much of what has been proposed was instigated by the UK, and indeed the proposed model for SPV's pretty much reflects current UK practice.

The EU Commission recognises complexity around vouchers and the need to standardise definitions around SPV's and MPV's particularly when issued in one Member State and redeemed in another. The overarching plan is to tax SPV's on issue and MPV's on redemption, so that, in the latter case, businesses would have a cash flow advantage between sale and redemption, and an absolute VAT saving in cases of non redemption.

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