INDIRECT TAX UPDATE

OCTOBER 2016

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EU

VAT Gap: Nearly €160 billion lost in uncollected revenues in the EU in 2014

The European Commission has released figures showing that VAT leakage within the EU is still a major problem across Member States – with almost €160bn in lost VAT revenues in 2014. This is based on the difference between expected VAT revenue and that actually collected (known as the VAT gap).

The Commission has announced an 'action plan' designed to tackle the VAT gap, with a view to moving towards reforming the VAT system across Europe, and reducing fraud and evasion, but the release of these latest figures indicate that much work in this area still needs to be carried out. Whilst the VAT gap has decreased by €2.5bn since 2013, eight of the 28 Member States have seen a reduction of VAT revenue collected compared to the previous year.

What this means

The extent of the VAT Gap is further indication that an urgent revision of the EU VAT system is needed in view of a number of challenges, in particular, the growth of the digital economy. Indeed, with the impending departure if the UK from the EU, this will add to the complexities of ensuring cross-border VAT compliance, and may in fact increase the potential for evasion of VAT on such cross-border supplies. Approximately €50bn of the VAT gap is specifically related to evasion of VAT. A long standing principle which is on the table is that of moving towards an 'origin' based' system, where intra-EU sales are treated as subject to local VAT, a measure which it would be hoped would significantly reduce the incidence of Inter-Community VAT fraud.

Ian Carpenter – RSM UK

UK

Court of Appeal decision – Longridge on the Thames

The Court of Appeal in the UK has allowed an appeal by HMRC, applying the principles set out in the Court of Justice of the European Union ('CJEU'), that the activities of an educational charity involved in water safety amounted to an 'economic activity' for VAT purposes. Consequently, the construction of a new training centre could not qualify for the zero-rated relief available in the UK for charities constructing buildings that will not be used for business purposes.

Importantly, the Court has rejected earlier rulings that have emanated from the UK courts regarding whether the receipt of income constitutes business activities in determining the status of income received - Longridge makes a charge for attendance on its courses but these are heavily subsidised and are certainly not designed to be 'commercial' - and placed more reliance on the European concept of 'economic activity'.

The Court notes from the earlier precedent CJEU case in Commission v Finland [C-246/08] that, as a general rule, an activity will be an economic activity where it is "permanent and is carried out in return for remuneration which is received by the person carrying out the activity". In this case, the Court ruled that Longridge did undertake an economic activity even though the payment received from users was subsidised and did not represent the full cost of the services. The amount of the charge was more than nominal in amount, and was directly related to the cost of the instruction, training and use of the facilities being provided. Concessionary charges do not prevent the application of the direct link test; economic activity is determined by receipt of income, not profit.

What this means

The issues in this appeal are of significance as they challenge the concept of an activity being 'intrinsically non-business' simply because it is concerned with carrying out the charity's core objectives. Charitable and not for profit institutions which carry out activities and make charges at any level, even if these are not regarded as commercial, can still run the risk of these being treated as business ('economic') activities with the VAT consequences that follow.

Andy Ilsley – RSM UK

NETHERLANDS

Recovery of VAT allowed on construction of a property sold at much lower value

In a not entirely unrelated case, the CJEU has ruled that the full amount of VAT on construction costs should be recoverable by a Dutch municipal authority that had constructed a building and sold it for a price less than the cost of constructing it.

The Dutch Municipality of Woerden ordered the construction of two buildings intended for multipurpose use and sought to recover the vast majority of the VAT incurred on the construction. The municipality then sold the buildings to a Foundation set up to manage the buildings and promote cooperation between the ultimate users. The sale price represented 10% of the cost price and VAT was charged on this amount.

The CJEU had been asked to confirm whether full VAT recovery was appropriate given that only part of the building was leased by the Foundation to tenants on a 'no charge' basis

The CJEU in its judgement reaffirms the important principle that the right of taxable persons to deduct the VAT due or paid on goods purchased and services received as inputs from the VAT which they are liable to pay is a fundamental principle of the common system of VAT established by EU law. In that regard, it is apparent from the case-law of the CJEU that the right of deduction is an integral part of the VAT scheme and in principle may not be limited and can be exercised immediately providing there is an evidential link to taxable activity.

With regard to the material conditions to be met for a right to deduct to arise, the CJEU has held that the goods and services provided that give entitlement to that right must be used by the taxable person for the purposes of his own taxed transactions, and that, as inputs, those goods or services must be supplied by another taxable person. Since there are no other conditions imposed relating to the use by the person to whom the goods and services at issue are supplied, it must be concluded that, provided the two conditions mentioned above are satisfied, a taxable person is, in principle, entitled to deduct input tax. The fact that the purchaser then allowed use of part of the buildings for no charge could not change that analysis.

What this means

The conclusion of the Court is that if the value of the sale is significantly below the cost of the asset it will not necessarily mean that the sale is not 'economic' in all circumstances such that the VAT incurred on the cost cannot be recovered. The full circumstances as to why the charge is lower need to be explored; the fact that the purchaser might use the property for non-economic purposes would not in itself affect the position.

Liesbeth de Groot – RSM Netherlands

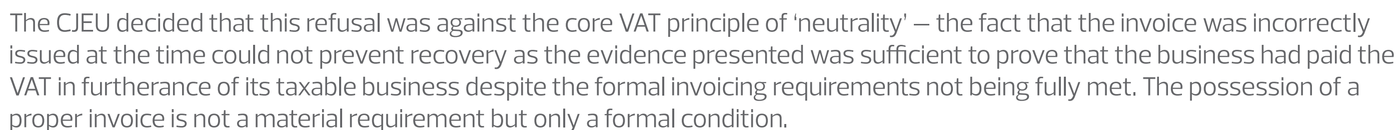
GERMANY AND PORTUGAL

Evidence for input tax recovery

Senatex Gmbh v Finanzamt Hannover-Nord

In the German case involving Senatex GmbH, the CJEU found that the business was entitled to a retrospective recovery of VAT on subsequent receipt of a subsequently corrected invoice.

Senatex ran a wholesale textile business. It had deducted input tax in respect of commission statements issued by its commercial agents and invoices issued by an advertising designer. This VAT was disallowed during a subsequent inspection by the German authorities as the invoices in question had not been properly issues according to German legislation as neither the supplier's VAT number nor his tax number had been quoted. The authorities still refused to allow the claim once the invoices had been corrected as, in their view, they could not have retrospective effect.



The CJEU decided that this refusal was against the core VAT principle of 'neutrality' – the fact that the invoice was incorrectly issued at the time could not prevent recovery as the evidence presented was sufficient to prove that the business had paid the VAT in furtherance of its taxable business despite the formal invoicing requirements not being fully met. The possession of a proper invoice is not a material requirement but only a formal condition.

Investimentos Imobiliários e Turísticos SA v Autoridade Tributária e Aduaneira

In a separate, Portuguese, case, the CJEU has also ruled that VAT should be recovered even if the details of the services supplied were not clearly described on the invoice. Barlis, a Portuguese company, operated hotels and restaurants and had recovered VAT on invoices for legal fees incurred. The tax authorities disallowed the recovery on the basis that the description of services provided was not precise enough – referring simply to 'legal services rendered from [a date] until the present date'. Although more detail of the work done was set out in accompanying schedules, these were not regarded as part of the invoice.

The CJEU found that the invoices did not comply with the requirements of the Principal VAT Directive as the statement was so general that it did not specify the nature and extent of the services rendered and it was not clear which period the services in question related to. However, in the CJEU's judgement, it ruled that the tax authorities could not refuse the right to deduct VAT on the sole ground that an invoice did not satisfy the conditions of the PVD provided they had available all the information to ascertain whether the substantive conditions for that right were satisfied – which in this case, they did, as the work was set out on the accompanying schedules. The right to deduct is absolute, and must be allowed if the substantive conditions for recovery are met.

What this means

In two decisions released on the same day, the CJEU has found that the failure to satisfy formal requirements should not prevent the recovery of VAT where other objective evidence exists that the VAT in question has been properly incurred by the business and is recoverable by it. This is encouraging news and provides more authority for tax authorities to allow claims on a pragmatic basis when the prime facie evidence of a properly addressed and annotated VAT invoice is not held, provided there is alternative evidence to support the claim.

Oliver Ehrmann – RSM Germany, and Filipa Azevedo – RSM Portugal

IRELAND

Road tolls – local authority is engaged in 'economic activity'

The Advocate General of the CJEU ('AG') has given an opinion that the National Roads Authority in Ireland is carrying out an 'economic activity' as a taxable person in respect of the operation and charging of road tolls, such that they would be subject to VAT, because there is at least a hypothetical possibility of the same activity being carried out by a private operator, even if not on the same stretch of road (private toll operators do operate tolls in other parts of Ireland, and in fact the majority are privately run). Whenever national law permits a body governed by public law to entrust the performance of a specific activity to private bodies, and the public body itself also performs that activity, there is a presumption that there will be a distortion of completion if the private body is subject to tax and the public body isn't.

The AG considers that the existence of distortions of competition must be analysed by reference to the type of activity involved, rather than by reference to the situation on the specific market. If there is no real possibility that an activity could be engaged in by private bodies then, as there is not even the potential of competition, there can be no possibility of competition being distorted. However, if there is a provision in the Member State's law affording the potential for private operators to carry out activities which are also undertaken by a body governed by public law, direct competition is no longer 'hypothetical'.

What this means

Because there is at least the possibility that private operators could in theory carry out the same activity, the activities of the public authority in this case can be subject to VAT. This is to be distinguished from countries like Germany, for example where tolls can only be run by a public body.

Bill Hunt – RSM Ireland

LUXEMBOURG

Application of VAT exemption for cost-sharing bodies

The AG proposes that the CJEU finds that Luxembourg has failed to properly implement the 'directly necessary' and 'exclusively' tests in its implementation of the 'cost-sharing exemption' within Article 132(1)(f) of the PVD.

The AG states that in order to be treated as exempt from VAT, the services provided by an independent group to its members must be directly required for the members' non-taxable or exempt activities and that cost-sharing group's exempt activities must be linked exclusively to the exempt activities of group members, although administrative (such as accounting) may fall to be genuine overheads attributable to both exempt and taxable supplies of the member.

Moreover, group members should not be allowed to deduct VAT charged to the group. Finally, the Luxembourg arrangements do not take account of VAT rules in EU law applicable to operations by intermediaries.

What this means

Under Luxembourg law, the services provided by an independent group to its members are exempt from VAT provided that the members' taxed activities do not exceed 30 per cent of their annual turnover (or 45 per cent under certain conditions). Group members are also allowed to deduct the VAT charged to the group on its purchases of goods and services. Lastly, recharges by a member in his or her own name but on behalf of the group are regarded as non-taxable.

The conditions under which VAT exemption applies for costs shared between independent members have been legislated for differently across the EU, particularly in respect of the allowed threshold of taxable activity that Member states will allow without jeopardizing the exemption. Although the AG does not appear to have specifically addressed the operation of a 30/45 per cent 'ceiling' for taxed operations, the CJEU may do so.

If the CJEU considers that the Luxembourg rule providing for a ceiling for taxed operations does not fulfil the 'directly necessary' and 'exclusively' conditions within the cost-sharing exemption, other Member States would have to review any similar thresholds as these may no longer be sustainable. In the UK, there is a 15 per cent ceiling for taxable activity.

Manuel Hack, RSM Luxembourg

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