Valentine’s day VAT

Large Corporate



03 May 2013

Maric Glaser reports back from the International Indirect Tax Conference. All references are to the Principal VAT Directive unless otherwise stated

Key Points

The history of the cost-sharing exemption Simplification of cross-border invoicing to provide proper audit trails How VAT fraud can, and does, happen to any business In triangular transactions, differences between member states can create uncertainty

The annual International Indirect Tax Conference took place on 14 February at the Royal Gardens Hotel in London. Delegates were again presented with a high quality programme of topical VAT issues.

Cost sharing

Stephen Coleclough, Deputy President of the CIOT, examined the history of the cost sharing exemption (**Art 132(1)(f)**) which, like provision for European Economic Interest Groups, aims to make it easier to share costs but applies only to bodies that make exempt supplies or carry on non-business activities.

EU-wide implementation

The exemption has been implemented in the EU in different ways, from Germany, which limits the exemption to the health and medical sector, to Luxembourg, which allows a deduction of VAT on the supplies. Both are subject to infraction proceedings.

The basics

The conditions for claiming exemption are:

- supplies must be by ‘cost sharing groups’ (CSGs) to their members;
- the services must be directly necessary for member’s eligible activities;
- recharges must be at cost; and
- there must be no distortion
- of competition.

Cost sharing groups

CSGs can take any form – partnership, company or other entity.

Used for an exempt or non-taxable activity

HMRC took the view that the words ‘directly necessary’ excluded the sharing of certain overhead costs, but now accept the CIOT view that shared overhead expenditure is a cost component of a member’s activity and therefore meets the condition.

Stephen commented that the test to determine whether the costs are referable to the exempt or non-taxable activity is the same as for partial exemption – if a shared cost is a cost component of the member’s exempt or non-taxable activity, the charges meet
the condition.

Further, HMRC have introduced very generous *de minimis* limits so that charges can be exempted, provided that at least 5% of all supplies/activity is exempt or non-taxable.

Exact reimbursement

Both EU and UK legislation makes it clear that the CSG must charge its members their exact share of expenditure incurred. It is, however, possible for a CSG to deal with non-members, but those transactions are not exempt from VAT.

Stephen noted that CSGs can make charges in advance to cover future or capital expenditure with later adjustments without breaching
this condition.

Distortion of competition

The legislation precludes exemption of transactions that results in distortion of competition. The Advocate General examined this condition in the case of ***Taksatorringen v Skatteministeriet* [2006] STC 1842**, commenting that all this requires is that the CSG should not be creating a customer base to earn profits. It seems likely that most CSGs will meet this condition.

Cross-border cost sharing

The legislation does not prevent exemption of cross-border cost sharing, although it appears that some member states do not agree and may subject incoming B2B charges to VAT.

Risks and issues for cost sharing groups

Getting things wrong can mean a 20% uplift in members' costs. The main entities likely to use the exemption are:

- charities;
- educational establishments;
- housing associations;
- betting and gaming operators; and
- financial services businesses.

It should be remembered that other solutions such as use of other exemptions, eg the education exemption, can achieve the same effect as cost sharing.

The Invoicing Directive

Ian Hayes, of European Fiscal Services Limited, introduced the Invoicing Directive, noting that, although in place for some time, issues still arise.

Background to the Directive

Behind the Directive lay a perception by member states and businesses that the single market provisions were not working. Concerns included the need for better harmonisation and simplicity in relation to cross-border invoicing. Fraud was also an issue. Invoices are important because they represent evidence for all involved and provide the audit trail needed to check the proper application of the tax.

The key changes

The biggest single change was the removal of the distinction between electronic and paper invoices and removal of restrictions on format, eg email can be used. Other changes include:

- removal of member states' powers to require different formats and additional information;
- simplification of self-billing (no permission required);
- removal of the requirement to invoice exempt supplies, although this was already in UK legislation;

- requirement of specific wording on certain invoices, eg reverse charge supplies; and
- record keeping, audit and storage requirements.

Place and time of supply

The invoice requirements reflect the need for clearer information on the place and time of supply.
However, problems include:

- how to deal with continuous and contingent supplies;
- determining jurisdiction where there is more than one country of establishment;
- dealing with special schemes, eg cash accounting; and
- different interpretations of requirements by different member states.

Storage, authenticity and audit

Administrative procedures, eg record storage periods, are left to member states. The Directive allows electronic storage but member states can require the storage of information needed to guarantee the authenticity, origin and integrity of invoices.

The future

To cater for problems of implementation and impending changes, such as the mini one stop shop, there will be a report back and possible further action in 2016.

VAT fraud: it couldn’t happen to us, could it?

Eileen Patching, VAT Fraud Policy, HMRC, said that large business and Missing Trader Intra-Community (MTIC) fraud posed the question as to whether fraud can happen to any business. She concluded that it could, and had. Businesses, therefore, need a strategy to avoid loss from unwitting involvement in VAT fraud with consequential loss of tax, penalties and interest.

Reducing the risk

A loss can arise where a businesses knew or ought to have known that a transaction was part of a fraud.

Businesses, therefore, need to know their suppliers and customers. A number of areas worth examination include:

- the business’s finance arrangements;
- credit record;
- transactions that look too good to
- be true;
- unusual conditions, eg the needless interposition of an intermediary; and
- how an unknown can match or undercut your purchasing power.

What business needs to do

Eileen explained that risk needs to be managed, so if something appears unusual, businesses should consider telling HMRC. They should not assume that HMRC do not know – large frauds do come to light and HMRC will seek redress if the business did not take sufficient care. Informing HMRC avoids or mitigates possible loss, as well as protecting a business’s good name.

She accepted that tax authorities have a responsibility for preventing fraud and that businesses only had to take reasonable care.

Triangulation

Dr Stefan Maunz, of Küffner Maunz Langer Zugmaier, considered the use of the simplification procedures in the PVD to avoid the need to register for VAT in triangular transactions, noting that although they offer relief they can create more burdens and uncertainty.

The basic model

Stefan outlined the issue using the following example:

- A (France) sells goods to B (Germany), which in turn sells them to C (UK), but A delivers the goods directly to C.

The normal rules

Using the normal rules:

- there is a UK intra-Community by B, since the transportation ends there.
- B also has a German intra-Community acquisition to account for, if B uses its local VAT ID;
- B makes a UK domestic supply and is obliged to register for VAT there; and
- B is not allowed to deduct the German acquisition VAT as input VAT.]

The conditions for simplification set out by the PVD

Stefan outlined the simplification rules for B and C (Germany and UK above):

- Rules in Germany (Art 42):
    - B needs not account for VAT on its deemed intra-Community acquisition, if it has made the intra-Community acquisition for a subsequent supply within the territory where C is established. B will report its sale to C in its european sales list (Art 256); and
    - C must pay VAT in the UK (country where established) (Art 197). Stefan noted that this is not provided for in German legislation, but it is a mandatory requirement.
- Rules in relation to B in the UK (where C is established) (Art 141):
    - B's intra-Community acquisition from A is not subject to UK VAT provided that it is not 'established' there and is VAT registered in another member state, if the intra-Community acquisition is for the purposes of a subsequent supply there and the goods are dispatched directly to C; and
    - B is not VAT registered in France (where A is established) and the transport is by A.
- Rules in relation to C regarding its acquisition from B (Art 197):
    - UK VAT is payable by C, if there is a taxable supply of goods by B carried out, according to conditions laid down in Art 141 PVD;
    - C must be UK VAT-registered; and
    - B's invoice must comply with Sections 3 to 5 of Chapter 3 of the PVD – otherwise local VAT
    - is applicable.

However, Stefan noted that member states may derogate from the above requirements in cases where C has appointed a tax representative.

Stefan then noted that problems arise for persons involved in intra-Community supplies because of differences in interpretation of the Directive's provisions (see

Table).

Risks and challenges

Other problem areas include:

- changes in supply chains, eg
- delivery terms;
- changes in a taxable person’s fixed establishments elsewhere;
- the accounting system’s capacity to meet formal requirements; and
- lack of awareness of operational staff of the potential tax issues.

Recent ECJ court cases and their impact

Stefan concluded with an examination of recent case law on the movement of goods, noting that while the European Court of Justice appeared to be taking a liberal view of the legislation, uncertainties remain.

Place of supply of services

Alan McLintock of Ford looked at the place of supply of services changes and their practical impact. Businesses face constant changes to the rules (four in five years), with the promise of more to come.

The place of supply of services

The biggest positive change was in relation to the place of supply of business-to-business services (Art 44). This shifted the place of supply from the place where the supplier has established his business to that where the customer has established his business.

With some exceptions (eg property services), the change eliminates the need to classify the type of service or decide whether there is one service or several.

Practical problems

Despite changes, problems still arise, eg a supplier may change and charge local VAT incorrectly. Alan said that Ford’s strategy was to proactively search and review

accounts payable invoices using low cost outsourced resources. This is backed up by input from the Office of Tax Counsel.

The rules determining the place where the recipient has established his business or has a fixed establishment can create problems, notwithstanding clarification in the Implementing Regulation (Regulation **282/2011EU**), which extends the concept of an establishment having sufficient human and technical resources to one having a sufficient degree of permanence and human and technical resources to receive and use the services supplied.

More difficult issues arise because of the provisions, whereby an intervention by an establishment in another country can affect the place of supply. Despite the efforts of the UK, the low barrier set results in uncertainty.

Is VAT incorrectly charged recoverable?

Alan then looked at the consequences of paying VAT which was not due. In ***Reemtsma Cigarettenfabriken GmbH v Finance Minister*** **[2007] All ER (D) 266**, the Court concluded that VAT not due is irrecoverable under the refund provisions. It follows that only VAT which is due should be paid.

Other things to consider

Alan commented on strategies that might simplify VAT management, including:

- centralising services into a
- single country, so there is a single reverse charge;
- rearranging the supply chain to avoid paying local VAT; and
- ensuring that systems enable local finance directors and controllers to comply with VAT requirements.

The use and enjoyment exception

Both the Sixth VAT Directive and the PVD allow member states to determine the place of supply of certain with non-EU counterparties as being where effective use and enjoyment takes place (Art 59a).

Alan noted that the lack of case law dealing with this provision can cause problems. Non-binding guidance issued by the VAT Committee does little to help and indeed

contemplates that there may be double taxation.

Specific problem areas

Alan pointed out problems with a number of types of services, eg:

- travel services subject to the Tour Operators Margin Scheme (TOMS);
- the treatment of storage, which may not be regarded as relating to land (***Minister Finansów v RR Donnelley Global Turnkey Solutions Poland Sp zo o* (case C-155/12)**);
- agency transactions; and
- conferences and events.

Conclusions

With further changes ahead and with countries looking to bring as much tax back home, every business needs to consider change and how to deal with it inside its own capacity.

EU case law

Jeremy Woolf, of Pump Court Tax Chambers, Chairman of the CIOT's EU and HR Sub-Committee closed with a review of recent EU case law.

***Veleclair SA* (C-414/10)**

The taxpayer deducted VAT on imports from China even though it had not paid the VAT on importation. The court concluded that payment was not required; Art 17(2) of the Sixth VAT Directive (Art 168) permitted a deduction for VAT due or paid. This is consistent with the principle of fiscal neutrality. It is for the authorities to institute procedures for the prevention of avoidance and abuse.

***Daimler and Widex* (C-318 and 319/11)**

The case concerns whether or not Daimler and Widex had establishments in Sweden where they carried out transactions. The court rejected the tax authority's contention on the grounds that the reference to transactions was to transactions in respect of which output tax was due.

Elsacom (C-294/11)

This case deals with the time limits for applications for refunds of VAT incurred from another EU member state. The court affirmed that the time limits are mandatory so a claim outside the time limits did not have to be paid.

Profitube (C-165/11)

Steel imported from the Ukraine and placed under customs warehouse procedures was sold in warehouse to the taxpayer, who sold it to a third party. The Slovak authorities argued VAT was due as the goods were supplied in Slovakia. The court concluded that VAT was not due on the importation but was due on their subsequent sale in Slovakia unless the country had exercised the option Art 156, allowing member states to exempt the sale of goods in a warehouse.

Mahagében kft (C-80 and 142/11)

These cases deal with the refusal of a VAT deduction on the basis that no supplies were made. The court concluded that the right to deduct was not dependent on the supplier accounting for VAT, unless the tax authorities had objective evidence showing that the trader should have made enquiries about the supplier's trustworthiness.

Mecsek-Gabona (C-273/11)

The taxpayer sold goods to an Italian who was responsible for the transport of the goods. The tax authorities could not trace the customer and assessed the taxpayer on the basis that it had not established that it had made an exempt intra-Community supply, notwithstanding that it has received CMRs from Italy and had relied on the customer's Italian VAT ID. That ID was subsequently cancelled by the Italian tax authorities.

The court concluded that: 'Once the vendor has fulfilled his obligations relating to evidence of an intra-Community supply, it was the latter that must be held liable for the VAT in that member state even where the transport obligation was not satisfied by the purchaser. This was subject to the supplier's obligation to act in good faith, which the national courts must assess.'

***VSTR* (C-587/10)**

A US company sold goods to a company in Finland, which were dispatched directly from Germany to Finland by the US company's supplier.
The German authorities sought VAT on the basis that the conditions for an exempt intra-Community supply were not met.
The court's approach was that national requirements should not be relied upon in a disproportionate manner to undermine the neutrality of the tax where the substantive requirements were satisfied.

***Kozak* (C-557/11)**

The case concerns the TOMS. The Polish authorities argued that in-house transport should be included as part of the calculation of the margin (standard-rated) because it was an essential part of the package. The court rejected that approach, citing ***Madgett and Baldwin* [1998] STC 1189** (joined cases C-308/96 and C-94/97) and concluding that only bought-in supplies were subject to the margin scheme.

TABLE

