The future of VAT

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Maric Glaser highlights some of the main points from the recent annual CIOT European VAT conference

A panel view

Donato Rapondi, the head of the TAXUD team responsible for VAT, together with **Peter Dylewski**, the Chair of the Conference, **Mike Arnold** (Land related services), **Tarlochan Lall** (CIOT representative on the VAT Expert Group), and **Justin Whitehouse** of Deloitte participated in a panel discussion about the direction in which VAT is heading.

Justin Whitehouse commented on the importance of VAT as a revenue source worldwide. Fully 150 countries had adopted a revenue-raising system based on VAT, 100 of them in the past 20 years. VAT accounted for more than 20% of tax revenues in the world. Change was being driven in different ways. In the EU, for example, this was carried out through its ongoing examination of VAT and through initiatives in the OECD.

He emphasised the need for business to be involved in the process to ensure that change reflected their needs.

Problems with effecting change

Donato noted that, despite the need for change, problems had arisen because of inherent limitations in the EU legislative process. The main problem is, as most tax advisers know, political: how do 28 member states agree change even when they all concur that it is needed?

This has led to the need to seek solutions outside legislation, perhaps through litigation. However, litigation requires an understanding of the nature of the European Court of Justice (CJEU) and how it works. First, it must be remembered that EU law covers a wide range of legal areas, not just tax. Donato suggested that perhaps there is a need for a special tax chamber similar to those that already operate in some member states.

The VAT Committee, set up under Article 398 of the Principal VAT Directive, comprises representatives of all member states and the European Commission. It may be asked questions either by the Commission or by member states or can of its own accord raise questions on VAT. The guidelines and working documents of the VAT Committee are now published and do have some impact on the CJEU, as recognised by the Advocate General Juliane Kokott, although strictly speaking they

have no legal force.

Darren Mellor-Clark pointed out the difficulties of a system of VAT for financial services that was developed in an age of significant manual input to one dominated by the use of technology, greater use of intermediaries and significantly less human resource.

Mike Arnold said the original system was principle-based but, over time and faced with political imperatives, member states and the European Commission have had to compromise some principles.

Tarlochan Lall expressed the view that, as legislation becomes more complex, greater use of guidance might be needed although difficulties arise with creating and agreeing guidance on which business must rely.

Financial services

Darren Mellor-Clark pointed out that the problems of how to tax financial services remained, primarily because there was usually no direct correlation between what was done and the value received in return. The original system of exemption, largely still in place, was adopted for reasons of convenience, but exemptions have created their own problems, such as blocked input tax feeds into the price of financial services. This can have an impact on how business is structured. Initiatives aimed at changing the VAT system to meet constant change have foundered in the face of conflicting interests.

Payment services

Driven by the CJEU, which has considered the issue several times, payment services have undergone some of the greatest changes. Among the principles established in determining whether exemption applies are: the identity of a supplier is irrelevant; and, for there to be a payment service, it must bring about a change in the legal and financial position of the parties. In *Bookit Limited v HMRC* [2006] EWCA Civ 550, the Court of Appeal elaborated on the essential functions of a payment service. However, despite guidance, problems remain, such as how to deal with outsourced services that play an essential role in effecting a payment but do not bring about the legal and financial change between the parties.

The rapid development of new services, such as peer-to-peer lending and the use of unregulated forms of currency, for example bitcoins for payment, have exacerbated the problems.

What next?

Darren suggested that there may be a need to allow more local options; understand the difference between and how to tax financial services as opposed to concentrating on the technical facilities required to deliver them. There is also a need to recognise and cater for the increasing entry into financial markets of non-traditional players and the development of new trading platforms.
Above all, there is a need for a clearer statement of principles to ensure consistency in treatment.

Immovable property

Mike Arnold updated the conference on work being done to better define what are regarded as land-related services and what emerged at a Fiscalis conference he had attended. That conference was convened by the European Commission with a view to developing Europe-wide guidance to help taxpayers understand the effect of the implementing regulation (Council Regulation 282/2011). Articles 31a and b, which deal with what are and what are not land-related services, come into effect in 2017.

The basic principle is relatively straightforward. To be a land-related service, there must be a sufficiently direct link with the land. But what is a sufficient connection will be a question of degree.

What emerged at the conference was that, notwithstanding unanimity on some principles, the views of different member states diverge greatly. Some of these dissimilarities are the result of differences in law such as between civil law jurisdictions and common law ones like those of the UK and Ireland.

Mike commented that there was a need to identify the issues and to provide examples. Members who have any comments or questions can be sent to the technical officers for indirect tax at indirecttax@ciot.org.uk. The CIOT has published its technical paper on land-related services on its website.

Some of the examples considered at the conference included:

- Is site security provided in connection with the construction of a building or works land-related? Issues here arise in relation to the nature of the security such as whether it is provided remotely using CCTV. Is it land-related?
- Is work done to install or remove substantial plant land-related? Does it make a difference if the building used to house the plant has to be erected around the plant and demolished to remove it? The answer is yes – but among the questions to be answered will how much the structure will need to be altered to remove the plant.
- What is the liability of a supply of construction equipment with an operator and without? Terms of contracts will become important as they will show who is responsible for what.

Fixed establishment

Bart Buelens of EY discussed the continuing evolution of the definition of a fixed establishment for VAT purposes and the dichotomy between the terms 'fixed establishment' used in VAT and 'permanent establishment' used in direct taxation. He noted that differences can have implications for the design of ERP accounting systems.

Using third party resources

In VAT's infancy, a fixed establishment had been seen as a place that had enough 'human and technical' resources (See *Berkholz v Finanzamt Hamburg-Mitte-Altstadt* (case C-168/84)) from which to make the supply. However, the case of Welmory examined that test in a different context: namely, when a supplier makes a supply using resources of a third party in another country where they have no resources of their own. The court concluded that a person can have a fixed establishment where the third party resources are, but it is for the national court to decide.

(In)dependent branches

Bart next considered the recent Skandia judgment in which the CJEU considered the question of whether a branch of a company should be regarded as part of a taxable person separate to its head office contrary to the treatment of inter-branch supplies in *FCE Bank plc v RCC* [2012] EWCA Civ 1290.

This is a subject that is developing rapidly with the Commission having sought the opinion of the VAT Committee. It is also being examined by the VAT Expert Group.

The VAT pro-rata

The case of *Société le Crédit Lyonnais v Ministre du Budget, des Comptes publics et de la Réforme de l'État* (case C-388/11) raises issues of how to determine the VAT that is deductible in respect of foreign branches. Since the conference, the UK government has published draft legislation purporting to respond to the judgment ostensibly restricting businesses from recovering the VAT incurred in managing foreign branches.

From a practical view, the question that arises is how to allocate local VAT incurred to foreign branches. For example, should a business look to split invoices at the start to avoid the need for apportionment?

Case law

Jeremy Woolf discussed several recent cases including:

Equoland Soc v Agenzia Delle Dogan (case C-272/13). He noted that the court had concluded that, although member states are entitled to seek penalties for non-compliance with VAT obligations, they must be proportionate. A penalty that in effect denied both the right to deduct VAT and imposed a 30% penalty above was inconsistent with the neutrality of the tax particularly since it could not be mitigated.

Idexx Laboratories Italia v Agenzia Delle Entrategmac (case C-590/13) was another of a line of cases concerning the denial of a taxable person's rights solely on the grounds of a failure to meet formal requirements. The court concluded that, if compliance with the substantive conditions for a deduction were met, it would be disproportionate to deny a deduction. Only where lack of compliance puts in doubt whether the substantive conditions are met would it be permissible to deny a deduction.

HMRC v GMAC UK (case C-589/12) [2014] STC 2603 concerned the use by a company of EU law to claim bad debt relief, while at the same time relying on UK law to avoid output tax on the sale of a repossessed car. The court concluded that they were two separate transactions and the taxpayer was entitled to rely on the national law for one while relying on EU law in the other. The court also appeared to

comment that this was not an abuse.