

Answer-to-Question- 1

### **Existing Arrangements**

#### **Importation of raw materials:**

As per article 60 of the Principal Vat Directive (PVD) the place of importation of raw materials from Malaysia shall be the Member state within whose territory the goods are located when they enter the community.

This will be in Bordonia, and therefore import VAT will be charged on the goods which will be fully recoverable since Asko is making taxable supplies.

#### **Sales of finished goods**

(a) Sales of finished goods sold to Bordonia customers will be subject to domestic VAT as this is domestic supply.

(b) Sales of electronic goods to business customers in other EU member states: the place of supply will be in Bordonia, per the provisions of article 32 but this transaction will be exempt with input tax credit per the provision of article 138.

Asko will need to obtain the VAT number of EU businesses, check this on the Europa website and state this on its invoice.

Most importantly it will need to retain documentary evidence that the goods have physically left Bordonia, in order to qualify for the exception following the facts of Teleos Case.

Asko will also need to raise an invoice to EU business customers along with a narrative that acquisition VAT is due at the member state of destination as per art 226.

This transaction will also need to be reported on the recapitulative statement per art 262.

(c) Sales of electronic goods to private customers (non taxable) in other EU member states

This will initially be subject to Bordonia VAT per art 32.

However Asko will need to clearly monitor its distant sales threshold per article 34 on a daily basis. If sales to individual customers in an EU member state exceeds the threshold of 35K or 100K, then the place of supply, per the provisions of article 33, shifts to the Member state of destination automatically.

Registration will therefore be required in that member state, and foreign VAT will have to be charged on the transaction.

Please note that as long as Asko remains under the threshold of 35K or 100k, it has a choice to voluntarily register in the other member states and charge foreign VAT. Art 34 (4)

(d) Sales of finished goods to the United States - the place of supply will be in Bordonia per art 32 but this however falls within exports exemptions per article 146 and will therefore be not subject to VAT.

Please note that Asko needs to retain appropriate documentary evidence about the export in order to qualify for the exemption.

### **Alternative Arrangements**

#### **Transactions with Balpa (Swiss Sub)**

The sale of intellectual property rights is considered to be a business to business B2B supply of services subject to article 44 which states that the place of supply shall be where the customer is located.

The transaction will be outside the scope of Bordonia VAT.

The sub-licensing of the IP from Balpa will also be deemed to be services received from abroad. These will be subject to a reverse charge in Bordonia by Asko, as per the provisions of article 196.

The reverse charge input tax will be fully recoverable provided that Asko is making taxable supplies.

Under the alternative arrangements Asko will be manufacturing the goods per Balpa's order. Balpa will therefore be acquiring the goods from Asko and will subsequently be selling these to Asko customers.

This is a triangular transaction between 3 different parties, but the intermediate supplier (Balpa) is non EU trader - hence simplifications cannot apply.

The sale of the goods from Asko to Balpa cannot be zero rate per art 138 because no EU VAT is provided to Asko by Balpa, and the sale of goods cannot be treated as exports because they never leave Bordonia.

As a result Balpa has to register for VAT in Bordonia and account for subsequent sales from Bordonia - charge domestic VAT for local supplies or zero rate the transactions to EU business customers and US business customers. (see top part - existing arrangements)

Asko will have to charge domestic VAT to Balpa, and Balpa will be able to recover this because it will be registered in Bordonnia and will be making onward taxable supplies or supplies exempt with credit.

It should be noted however that as per the facts of VSTR case, the ECJ ruled that as long as the traders acted in good faith, and as long as alternative evidence existed which confirmed the taxable status of the intermediate non-EU supplier (i.e. Balpa) the zero rating to the intermediate supplier (Balpa) by the initial supplier(Asko) was possible, as long of course the acquisition VAT was accounted by the end customer.

#### Sale to another Group Company

The sale of the business to the other group company will be treated as a transfer of the totality of assets of the business per the provision of article 19 and will therefore be outside the scope of VAT in Bordonia.

As per the facts of Kijkers case, going concern of the company is not a criterion as far as the

application of art 19 as long as the wherewithal of the business (plants, building, machinery and staff) are transferred.

Per Zita modes case it has also been pointed out that exemption per art 19 applies as long as the acquirer does not intend to liquidate the business.

Customer in Thebia

In this case Balpa will be effectively making supplies of goods from Thebia and will therefore need to register for VAT in Thebia and apply domestic VAT.

Do note however that "call off" stock simplification provisions may apply in Thebia. Call off stock is considered to be stock which has been transferred to a clients warehouse awaiting its pick up or disposal. The key consideration is that a client has been found.

If call off stock simplification apply then the transaction will be treated as a normal EU despatch. No registration will be required in Thebia by Balpa.

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Answer-to-Question-2

To: La Grosta Finance Director  
From: VAT Advisor  
Re: Various Transactions and VAT implications

Dear finance director,

Kindly find below my responses with respect to the various transactions and VAT implications there in

First of all its important to point out that the work of haulage, storage, and cargo handling business is a sale of services and will therefore be subject to the VAT rules for services under the

Principal VAT Directive.

1. The work for a Netherlands business clients with respect to the unloading of goods from road trailers is a B2B transactions which is subject to the basic rule per article 44. Article 44 states that the place of supply is where the customer is established.

As a result, the transaction will be outside the scope of Diabalo's VAT. La Grosta will have to raise an invoice however as per art 225 and include a narrative that a reverse charge has to be applied at the member state of destination (France).

It will also need to report this on its recapitulative statement.

2. As an introductory note it is helpful to point out the goods/cargo which are found in customs warehouses and custom duties are exempt from any importation VAT. Importation VAT is charged only when the enter EU territory.

As a result the services of the loading of cargo from the customs warehouse at the request of the Cyprus customer is a transaction which relates directly to the importation of goods.

This service is specifically exempt per the provisions of article 146 (e) and hence the transaction will be exempt from VAT with a credit for input tax.

3. The VAT treatment of the transportation of goods from Diabalo, through to another EU member state, and back to premises 500K south in Diabolo depends on whether the client is a taxable business, or a non taxable person.

If this is B2B transaction, basic rules apply as per art 44 and the place of supply will be where the customer is established. If the customer is established outside Diabalo then the transaction will be outside the scope of Diabalo.

If this is a B2C transaction - business to non taxable consumer - then the place of supply of the intra community transport of goods, per the provision of article 50 of PVD, shall be the place of departure. As a result domestic VAT will be applied.

4. The VAT treatment of providing storage space to a charity will depend on whether the charity

is registered for VAT purposes.

Usually charities are not registered and are considered to be a non-taxable legal persons. As a result they will be subject to the basic rule per the provision of article 45 which states that the place of supply of services to a non taxable person will be the place where the supplier is established. That will be in Diabolo and hence domestic VAT will be charged.

If the charity is registered with VAT, then this will be a B2B supply per the provision of article 44 and hence the transaction will be outside the scope of VAT. Again an invoice will have to be raised with a reverse charge narrative and this has to be reported on the recapitulative statements.

5. The work for the Australian government which includes unloading goods from military vessels in Diabolo main port will depend on whether the Australian government acts as a taxable authority or as non taxable person.

If this is treated as non taxable person then provisions per article 54.2(b) apply - which specified that the place of supply of activities such as loading, unloading, handling and similar activities will be the place where they are physically performed. Hence domestic VAT will be charged.

If the Australian government acts as a taxable person/taxable public authority then per basic B2B rules (art 44) this will be outside the scope of VAT.

It should be noted that the exemption per article 151 may apply which consider the supply of goods or services under diplomatic arrangements to be treated as an exempt export.

6. The work performed for a Spanish client, involving the repackaging of goods in transit for onward transportation by a different business to South America is likely to fall within the scope of the exemption in article 146(e) as it relates directly to the exportation of goods.

The transaction will be zero rated with a credit for input tax.

7. The first thing to consider with respect to the sale of the shares in the subsidiary is whether the subsidiary is actively managed.

If the subsidiary is not actively managed and LaGrosta is passively holding its shares, then Polysar case applies and any sale of the subsidiary is treated as outside the scope of VAT. Any

input tax incurred with respect to the sale will not be recoverable.

However, the facts of the case indicate that the subsidiary is actively managed. The fact that no invoices have been raised is a different issue which may be considered by the authorities as a deemed supply of services. The substantive requirement that the holding company is actively managing the subsidiary is met.

If this is the case the sale of the shares falls within the scope of VAT, but the transaction is exempt pursuant to the provisions of article 135 - exemptions in shares (f)

Per the facts of BLP Group case, the VAT with respect to sale of the subsidiary will most probably be directly related to the exempt transaction and hence it will be disallowed for VAT purposes.

However, as per the facts of AB SKF case, the sale of the subsidiary may be treated as the sale of business as a going concern, and the cost of sale may be treated to be a cost component of the seller's business. As long as the subsidiary company is making taxable supplies then the input vat on the selling costs could be recovered.

This is less likely scenario however, because no state has yet been able to enforce the ruling per the AB SKF case. It is therefore likely that input tax on the selling costs will not be recovered.

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Answer-to-Question- 3

### Introduction

The concept of establishment in VAT is indeed very important and has indeed been the subject of many ECJ cases. The status of a trader being established or not in a member state has also wide implications and this will be practically explained below through an examination of the most important case in EC law.

### The Concept of Establishment

The concept of establishment was first put forward in **Planzer case**.

As per the Implementing regulation Art 10 the place of establishment shall be where the functions of the business's central administration are carried out.

In order to determine this account shall be taken of the place where essential decisions concerning the general management of the business are taken, the place where the registered office of the business is located and the place where management meets.

### The Concept of Fixed Establishment

Apart from the concept of establishment the concept of fixed establishment is equally important and is explicitly defined in implementing regulations art 11.

A fixed establishment shall be any establishment, other than the place of establishment referred to in art 10, characterized by a sufficient degree of permanence and a suitable structure in terms of human and technical resources.

### Consequences / Why is the concept of establishment is important / Case law

The concept of establishment is important for two important reasons

1. First of all it effects the application of the basic rules of services per article 44 and article 45, as it determines the place of supply:

Article 44 states that the place of supply of services to a taxable person acting as such shall be the place where that person has established his business. However if the services are provided to a fixed establishment of the taxable person the place of supply shall be where the fixed establishment is located.

In short this means that establishment or fixed establishment determines where the customer belongs for the application of article 44.

Article 45 states that the place of supply of services to a non taxable person shall be where the supplier has established his business. However if those services are provided from a fixed establishment of the supplier, the place of the supply shall be the place where that fixed establishment is located.

In short this means that the establishment or fixed establishment determined where the supplier belongs for the application of article 45.

The following EC cases highlight the important of establishments/fixed establishment

**Berkholz case** - this concerned the supplies of gaming machines installed on ferries. The trader argues that the gaming machines constituted a fixed establishment and therefore any supplies in non-EU waters were outside the scope. The ECJ however ruled that the gaming machines were not characterized by a sufficient degree of permanent in terms of human and technical resources and hence no fixed establishment arose.

**Welmore case** - this concerned a Cyprus company doing online auctions and charging individual customers a fee to participate in the auction. The company received advertising and support services from a Polish company. The Polish authorities argued that fixed establishment occurred in Poland and that Polish VAT should be charged. The ECJ left this to the national court to determine whether the facts were such to justify a fixed establishment in Poland.

**DFDS Case**- A Danish operator established a UK subsidiary to find clients. The UK subsidiary charged 15% commission on the value of the sales. However the authorities argued that the UK subsidiary of the Danish Group constituted a fixed establishment and UK VAT should have been accounted on the gross value of the sales.

2. The concept of establishment also determined the application of article 192:

Art 192 specified that a taxable person who has a fixed establishment within the territory of a member state shall be regarded as a taxable person who is NOT established in the member state when

- (a) he make a taxable supply of goods or services
- (b) the fixed establishment does not intervene in the supply.

Implementing reg 53 goes on to explain that a fixed establishment is concerned not to intervene in the supply, unless the technical and human resources of that fixed establishment are used by him for the transactions inherent in the fulfilment of the taxable supply.

Case Law Example: A UK law firm has a branch in Paris. A customer from Paris requests a legal service for which the expertise only exists in London. Hence a UK partner flows to Paris to service the client, and the London office raises an invoice. In this case the Paris branch (fixed establishment) does not intervene in the supply and hence no French VAT is applied.

3. The concept of establishment also determines whether a trader can use the provision of the cross border refund scheme as per Directive 2008/09/EC.

As per this Directive Art 3, the directive applies only to taxable persons NOT established in a member state of refund who meet the following conditions:

- a. during the refund period he has not had in the member state of refund his seat of economic activity or a fixed establishment and
- b. during the refund period he has not supplied any goods or services in the member state of refund.

### Conclusion

As you can understand therefore the concept of establishment is particularly important and determined the wider application of the Principal VAT Directive.

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Answer-to-Question- 4

### Fiscal Neutrality

This is a concept which means that VAT should be imposed in such a manner so as not to distort competition within the European Union.

The Preamble of the PVD specifically art 5 states that

"A VAT system achieved the highest degree of simplicity and of neutrality when the tax is levied in as general a manner as possible and when its scope covers all stages of production and distribution as well as the supply of services"

Further more Preamble art 5 states that:

"The common system of VAT should, even if rates and exemptions are not fully harmonized, result in neutrality of competition, such that within the territory of each Member state similar goods and services bear the same tax burden"

The concept of Fiscal Neutrality has been the subject of many EC case.

#### a. Legal Vs Illegal Transactions

The ECJ has repeatedly emphasized that as long as non-legal activity competes directly with a legal market its activities will also fall within the scope of the directive.

Examples:

**Goodwin case**- the sale of counterfeit perfume was taxable because it was deemed to compete with the legal market of sales of perfumed.

**Mol case** - the sale of illegal drugs or narcotics was not within the scope of vat because there was no legal competitive market.

#### b. Exemptions per article 132

In order to preserve fiscal neutrality exemptions have to be mandatory and interpreted very narrowly

For example the Commission took infringement proceeding because France did not treat blood samples as within the scope of medical exemption

Also the commission took infringement proceedings against Italy because it considered vet services to be exempt where vet services are not specifically listed in article 132.

c. Public Authorities

Public authority activity also fall within the scope of fiscal neutrality. If a public authority carries on activities which compete with local providers then per article 13 considered to be a taxable person and VAT is due on their services.

Famous case law cases include the Car Parking case, and the UK tolls case.

Legitimate Expectations

The principle of legitimate expectation says that when the Directives gives a taxpayer an expectation about a legitimate tax advantage national legislation should not take this away.

The idea of legitimate expectations was demonstrated in the following cases

**Marks & Spenses case** - the UK introduced immediate and retrospective applications with respect to the claim of VAT. The ECJ ruled that this was inappropriate and transitional measures were required. The taxpayer has a legitimate expectation which should not be taken away overnight.

**Ghent Coal case** - a company purchase land and incurred VAT and was planning to use that for genuine trade purposes. However it was forced to sell this under a compulsory sale procedure and the authorities tried to claw back the VAT. The ECJ ruled that this was not possible as the company has genuine intention to trade and hence a legitimate expectation that the VAT was recoverable.

Inzo Case - the concerned the recovery of input vat on a consultants expenses which advised the company that it had to go into liquidation. Again the ECJ argued that input tax could not be clawed back because it related to a legitimate expectation.

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The office block falls within the provision of a capital goods scheme.

As per art 187:

Per the PVD the adjustment shall be spread over the adjustment period including that in which the goods were acquired

In case of immovable property the adjustment period may be up to 20 years. (in this scenario 10 years)

The annual adjustment shall be made only respect of one tenth (1/10) of the VAT charged on the capita good.

As per art 188

If the immovable property is supplied during the adjustment period, the capital goods shall be treated as if they had been applied to an economic activity of the taxable person up until expiry of the adjustment period.

The economic activity shall be presumed to be fully taxed in cases where the supply of the capital item is taxed, and the economic activity shall be presumed to be fully exempt in situations where the supply of the capital good is exempt.

#### Adjustments required based on the facts of the scenario

Year 1:  $200\text{m} \times 25\% \times 80\% = 40\text{m}$  (recover 40m)

Year 3:  $200\text{m} \times 25\% / 10 \text{ years} \times (55\% - 80\%) = - 1.25\text{m}$  (repay 1.25m to the authorities)

Year 5: No change in the percentage with respect to the percentage of 80% therefore but the adjustment with respect to the sale must be calculated. Since the sale took place at the end of Year 5 it will be deemed that there are 5 more years remaining to the end of the adjustment

period. The supply is also taxable and hence

$200 \times m \ 25\% / 10 \text{ years} \times (100\% - 80\%) \times 5 \text{ remaining years} = 5m$  (recover an additional 5 million)