THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2017

PAPER 3.02 – EU VAT OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Asko GmbH currently makes supplies of goods in Bordonia to both domestic business customers and those in other member states. They make these goods from raw materials imported from Malaysia on which VAT will be chargeable at import which is likely to be deductible as input tax because of its intended use for making taxable supplies of finished goods.

Supplies involving the removal of goods to a destination in another member state shall not be liable to VAT in Bordonia under Art 138 PVD providing the customer's VAT registration number is recorded on the invoice and evidence of removal from Bordonia is also retained by Asko. These sales need to be recorded on an intra-community sales list or recapitulative statement and will be subject to acquisition tax in the member state to which they are removed, this will normally be accounted for by the customer on their VAT return. Intrastat returns (monthly or quarterly) will also need to be made if annual intra-community dispatches exceed the threshold applicable in Bordonia. Intrastat returns must be made between 10 and 30 days from the end of the reference period, Reg 638/2004 refers.

Supplies to customers in the USA are not liable to VAT under Art 146 PVD providing evidence of export is retained by Asko.

If the group changes its business model to that of a "toll manufacturer", the following supplies are likely to be made:

1. The sale of Intellectual property (IP) to Balpa is a supply of services. In this case the supply is to a business established in Switzerland (outside the EU) and the place of supply is where Balpa is established - Switzerland. No domestic VAT is chargeable on the sale of IP. Art 44 PVD refers.

2. Balpa will need to register for VAT in Bordonia as a Non-Established taxable person because of the requirement to account for VAT on acquisitions of raw materials from suppliers in other member states and due to it making supplies of finished goods to domestic and overseas customers previously supplied by Asko. These supplies will be treated in the same way as those described above under Arts 138 and 146 PVD.

3. The licence for the use of technology by Balpa to Asko GmbH is likely to require a royalty payment which will be subject to a reverse charge by Asko, who are likely to be fully taxable and able to recover any associated input tax in full.

4. Asko will change from supplying goods in which it holds title, to a service provider performing services on goods belonging to Balpa. Because the customer is in business and established outside the EU the place of supply of the service will be Switzerland and no VAT will be charged despite the fact that Balpa is registered for VAT in Bordonia.

5. Under the alternative option if any assets located in Bordonia are sold to Balpa in-situ without removal from Bordonia, domestic VAT will usually be chargeable. An alternative treatment would apply if the assets constitute the assets of a business or part of a business transferred as a going concern to the purchaser (Balpa) who intends to carry on the same type of business of manufacturing. In such a case the purchaser would need to register for VAT in Bordonia in advance of the transfer and may take ownership of the assets as a non-supply under Art 19 PVD providing that provision has been enacted in Bordonia..

The future supplies to the customer in Thebia may be provided as "call-off" stock as long as the goods are stored at the customer's premises in Thebia and are only available for use by that single customer and that Member State allows 'call off' stock. In this case, although title to the goods stored in Thebia cannot pass until the goods are required by the customer, the customer will account for any acquisition tax on movements of goods from Bordonia to Thebia, removing the requirement for Balpa to register for VAT in Thebia. This simplification is allowed as a departure from the usual treatment of EU movements of goods under Art 17, Art 138(2)(c) and Art 21 PVD.

Question 2

Finance Director,
LaGrosta,
Diabalo EU

15th June 2017

Dear Finance Director,

VAT liability of transactions

I am replying to your enquiry concerning the place of supply and VAT treatment for the activities detailed in your letter. For ease of reference I will respond in the order used in your letter.

1) The most important aspect in determining the place of supply is to identify if your customer is in business and if so, where your business customer is established. As this is a Netherlands business customer the place of supply is the Netherlands and you do not need to charge VAT as your customer will operate the reverse charge. It does not matter in these circumstances where the activity is performed because your customer is in business and that feature determines the place of supply.

2) The place of supply of loading cargo for export from the EU to Turkey for a business customer in Cyprus, is where the customer belongs i.e. Cyprus. There is therefore no VAT due in Diabalo and the customer should account for VAT in Cyprus under the reverse charge provisions. However, as the services are directly connected to an export of goods placed in a customs warehouse and are ancillary to transport, they fall to be exempt with credit (i.e. the right to recover input tax) under Article 146.1 (e).

3) The place of supply of the transportation of goods to business customers is given by Article 44 (the place where the customer belongs) but to non-taxable persons it is given by Articles 49 – 52. Whilst the status and location of the customer is unknown, and therefore a definitive answer is not possible, assuming that the customer is in business and belongs in Diabalo, the place of supply will be Diabalo; if the business customer belongs outside Diabalo, no VAT in Diabalo is due and the reverse charge will apply in the business customer's place of belonging, assuming this is in the EU. If the customer is not in business, the place of supply will be where the transport takes place i.e. Diabalo (see Article 49). The transport takes place in Diabalo and is not intra-community because the place of departure and the place of arrival are in the same country (see definition in Article 51).

4) The letting of immovable property generally requires the location of the property to determine the place of supply, in this case Diabalo. The charity may be a non-taxable person but this does not make a difference because the rules at Art 47 do not recognise the status of the customer as being relevant to the analysis.

5) A national government is usually treated as a non-taxable person under Art 13 PVD. The unloading of goods from a military vessel for a non-taxable person would usually be expected to have a place of supply where the supplier is established, in this case Diabalo, Art 45 PVD. The tax charged is unlikely to be eligible for refund under the 13th Directive because the recipient is not in business.

6) Repackaging goods for a Spanish business client is a supply of services treated under the general rule as being made where the customer belongs. The fact that the goods are in transit for export from the EU does not affect the place of supply of the service but for the purposes of the reverse charge in Spain, the arrangements could be viewed as falling within the exemption (with credit) under Art 146.1(d) PVD.

7) The holding of shares in a subsidiary company is generally not regarded as an economic activity under the principles established in Polysar (C- 60/90). However in cases in which

holding companies have taken an active role in the management of subsidiaries the CJEU has held that the holding and management of investments constitutes economic activity , Cibo Participations (C-16/00) or Larentia + Minerva (C-108/14) and related input tax has been recoverable to the extent the holding company made taxable supplies. In the current case LaGrosta is making taxable supplies in its own right as well as holding and disposing of investments without raising a charge for the management of the subsidiary. The CJEU decision in MVM (C- 28/16) held that the management of subsidiaries without charge is not an economic activity for which input tax can be recovered. As this is the position with LaGrosta it follows that VAT incurred in relation to the holding in the subsidiary cannot be recovered.

I trust this is helpful and would be pleased to provide further assistance if required.

Yours faithfully,

ADIT Candidate

PART B

Question 3

Determination of the place of establishment of an entity or person is a key element of EU VAT because it affects many issues, including eligibility for registration, place of supply, entitlement to recover VAT and whether VAT should be charged.

The principal EU legislation determining the place of establishment is at Articles 10 to 13 of the Implementing Regulations IR 282/2011. These are particularly relevant in the case of supplies of services within the scope of Articles 44 and 45 PVD which initially require determination of the recipient of a supply as either a taxable or non-taxable person respectively. The primary test for determining the place of a business establishment (for the purposes of Art 44 and 45 PVD) is "where the functions of the business's central administration are carried out".

The main areas in which the difference in VAT treatment between those Established and the Non-Established include:

Registration

It is a general requirement that a business registers in the member state in which it makes supplies, or in limited circumstances, where it receives supplies. However, there are contrasting treatments dependent on whether the entity or business is established in that member state or elsewhere. There are also exemptions for small enterprises laid down in Arts 281 to 292 PVD which allow member states to apply exemptions to transactions carried out by small businesses whose annual turnover is below a specified threshold. The position has been influenced by the CJEU decision in Schmelz v Finanzamt Waldviertel (Case C-97/09) [2011] STC 88 which determined that a business established outside a member state does not benefit from any VAT registration threshold that may be available to one established in that member state. This effectively means that non-established businesses may need to register for their first supply in any member state in which they make supplies, whereas established business will have the benefit of not needing to register until their annual value of supplies exceeds the national threshold.

Reverse charge

A business or VAT registered non-taxable person who is recipient of a supply of services made from outside a member state will generally fall within the scope of Art 194 or 196 PVD and be required to account for the VAT on that supply through the use of the reverse charge mechanism. It is therefore important for the supplier of services to correctly identify their customer's place of establishment because they will need to charge domestic VAT to a customer established in the same member state as themselves, but will not need to charge VAT if the business customer is established elsewhere. There are additional rules under Art 38, 39, 44 and 45 to cover the situations where supplies are made or received by fixed establishments of the supplier or recipient which belong in a Member State which differs from their business establishment, Art 192a PVD refers.

Recovery of VAT incurred

In circumstances in which a business has no direct entitlement to register for VAT in a given member state, any VAT incurred may be recovered under one of two procedures. Those businesses established in a different member state to that in which VAT has been incurred may use Dir 2008/9 to seek to recover VAT incurred. In contrast taxable persons established outside the EU will need to use the "13th Directive" procedure laid down in Dir 86/560. Each procedure has differing claim formats and time periods before which claims must be made. The terms of the 13th Directive cannot be more favourable than those available to EU businesses and are dependent on the existence of reciprocal arrangements available to EU businesses incurring VAT in the third country. Some member states require the appointment of a VAT representative before a valid claim can be made.

TBES supplies

Since 1.1.15 suppliers of telecommunication, broadcasting and electronic services to non-taxable persons are treated as making supplies in the member state in which their customers are established, Art 58 PVD. Suppliers who are established in the same member state as their customers will account for VAT in the same way as those who make domestic supplies of goods and services Art 57c IR. However, suppliers who are established within the EU but not established in their customer's member state may use the "Union scheme", a simplification procedure which allows the supplier to account for VAT on all such supplies made throughout the EU by making a single VAT registration and return in one member state under Art 369b PVD. Suppliers who are not established within the EU may use the "Non-Union scheme" under Art 359 PVD and seek registration in the member state of their choice.

PART C

Question 4

Fiscal Neutrality

Fiscal neutrality is a concept which has proved difficult to define as it is to a large extent aspirational and imprecise. That said, it refers to the overall approach to VAT which seeks to ensure that VAT is not a charge upon economic operators who are intended not to bear the burden of the tax, provided that their activities are subject to VAT. It is referred to by both the EU and the OECD in their guidelines regarding the application of VAT/GST and is widely regarded as consisting of two principles.

The first principle is that VAT is a tax on consumption and that the deduction of input tax is designed to relieve the burden of the tax, whilst taxing the final consumer – "the First Directive Principle".

The second principle is that businesses should be treated similarly for tax purposes – "the Parity Principle".

The majority of case law surrounding the First Directive principle has been concerned with the deductibility of input tax in relation to business that make taxable supplies to consumers through a supply chain of several taxable persons, in contrast to where tax is incurred on exempt activities or in circumstances where the supplies have ultimately not been used by the claimant business. A further aspect of this principle is that the amount of tax borne by an ultimate consumer cannot be greater than the amount due on the consideration paid for the final supply to the consumer per Elida Gibbs (C-317/94) which allowed a reduction in the value for VAT purposes for a manufacturer who made promotional payments to consumers of its products. The overall effect is that VAT should be fully deductible throughout a supply chain where the final supply is subject to tax. The effect of the First Directive principle is that the tax is completely neutral as regards its effect on a taxable person who makes only taxable supplies (other than the administrative costs of accounting for VAT, and subject to specific exclusions).

The second principle is concerned with trying to ensure a level playing field and it precludes treating similar goods and supplies of services, which are thus in competition with each other, differently for VAT purposes, so that those goods or supplies must be subject to a uniform rate. This principle has been applied to:

1. The concept of unjust enrichment, which at one time was unjustifiably applied to payment traders but not repayment traders selling the same product; Marks & Spencer plc (C-309/06);
2. financial products, where essentially similar products were treated differently for tax purposes; JP Morgan Fleming Claverhouse (C-363/05);
3. healthcare services, where it has been held that the tax treatment of such services could not be dependent on the legal persona of the taxpayer; Jennifer and Mervyn Gregg (C-216/97);
4. gaming machines, regulated under different gambling legislation. Rank Group plc (C-259/10); and
5. where car parking facilities are supplied by public bodies and private businesses in competition or potential competition with each other - Isle of Wight Council (C- 288/07).

Examiner's note – there are many cases that have considered fiscal neutrality which could be quoted in answers to this question. De Voil Indirect tax V1.230B contains a comprehensive list which could include: Purple Parking (C-117/11); K Oy (C-219/13); Belgocodex SA (C381/97) and Card Protection Plan Ltd (C-349/96).

Legitimate expectation

Legitimate expectation is the term used to describe the doctrine under which a party (usually a business) can place reliance upon the position of an authority whether made through policy, statute or similar means, in which it may place confidence in understanding the treatment it may reasonably expect to apply to a transaction or course of action. It is not fundamentally an EU concept although it has been applied to EU tax and other matters through the judgments of national courts and the CJEU. One of the better known CJEU VAT cases concerning this point is Marks & Spencer (C- 62/00) in which it was held that national legislation retrospectively curtailing the period for exercise of a right of a taxpayer provided for in the 6th EU VAT Directive, was incompatible with the principle of legitimate expectation. The principle has also been established in Sudholz (C-17/01) where it was held that Article 3 of Decision 2000/186 was invalid due to the violation of this principle, in that it allowed for a change of tax treatment, to the detriment of the taxable person, retrospectively. In general terms, the principle of legal certainty precluded a Community measure from taking effect from a point in time before its publication.

Examiner's note – there are many cases that could be quoted in answers to this question. De Voil Indirect tax V1.230G contains a comprehensive list.

Question 5

A member state may make a referral for a preliminary ruling to the CJEU under the provisions of Art 267, Treaty of the Functioning of the European Union (TFEU). A preliminary ruling referral may be made in respect of:

1. the interpretation of the Treaties; or
2. the validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union;

by any domestic court providing the referring body has a statutory origin and it must be permanent. It must also include an inter-partes procedure, have compulsory jurisdiction and it must apply the rule of law. These criteria were affirmed in Case C-17/00 De Coster v Collège des Bourgmestre et Échevins de Watermael-Boitsfort [2001] ECR I-9445.

The national court or tribunal of any member state has discretion, under Article 267(2), to refer a case if it considers that a decision on a question of EU law is necessary. That is, it is not acte clair.

Under Article 267(3), there is an obligation to refer a case concerning a question of EU law by any national court or tribunal against whose decision there is no judicial remedy. The CJEU favours the concrete theory, meaning that Article 267(3) would apply to the highest court in a particular case.

In the majority of cases a view will be provided by the Advocate General which although influential may not necessarily be followed by the Court. The Court of Justice Decision has the force of res judicata. It is binding not only on the national court on whose initiative the reference for a preliminary ruling was made but also on all of the national courts of the Member States.
The preliminary ruling procedure is essential to the uniformity of the Union, allowing the CJEU to develop and clarify key principles constructing the legal system of the European Union. Nevertheless, broad interpretation of what constitutes a court and tribunal and the increasing number of discretionary and mandatory references further expands the scope of the procedure. Member states may be liable for damages in cases in which they have failed to adequately implement EU Directives into domestic legislation.

The most notable VAT case concerning Direct Effect has been Becker (C- 8/81) which remains a leading case. Becker was concerned with a self-employed credit negotiator who invoked before her German national court an Article in the 6th VAT Directive which enabled the exempt treatment of the granting and negotiation of credit. Germany had not yet implemented the Article into national law. Becker wished to apply the exemption to the period of time from the end of the expiry period for implementation until the German law changed. The ECJ subsequently held that when a Member State has failed to implement a Directive correctly and not before the end of the period prescribed for implementation, that it had breached Article 189 of the EU Treaty which states that a Directive shall be binding upon each Member State. The court concluded that it would be incompatible in view of the binding Article to exclude the possibility of the obligations imposed being relied upon by persons affected. Consequently a Member State which has not adopted the measures required by a Directive in time may not plead, as against individuals, its own failure to perform the obligations that the Directive entails.

Other tax cases in which Direct Effect has been considered include:

- Linneweber & Akriditis (C-453/02 and C-462/02) the CJEU found that Article 13B(f) of the Sixth Directive had direct effect which could be relied upon by an operator of games of chance or gaming machines against national rules which were inconsistent. In this case the German government had made the exemption dependent on the identity of the operator.

- In JP Morgan Fleming Claverhouse Investment Trust (C-363/05) the ECJ found that Art 13B(d)(6) of the Sixth Directive had direct effect and that the words ‘special investment funds’ are capable of including close-ended investment funds such as Investment Trust

Companies. In exercising the Member State's discretion in defining 'special investment funds' the Court said the UK had to respect the objective of the exemption.

- In British Film Institute (C-592/15) the CJEU held that the wording in the Directive was not precise enough for it to have direct effect such that admission to cinemas should be exempt.

Question 6

The VAT treatment of face value vouchers has been subject to consultation following the Commission making proposals in 2012. The main reason for the consultation was the perception that Member States were not treating vouchers consistently, particularly where cross border transactions were concerned which could lead to the double taxation and non-taxation of transactions involving vouchers. The Commission noted that 70% of the EU voucher market related to pre-paid telecommunications, followed by gift vouchers and discount vouchers. Vouchers which are issued and redeemed in different member states have also been particularly problematic for VAT.

The consultation and proposals follow a significant line of cases involving payment using vouchers which have been referred to the CJEU. These include Argos Distributors (C-288/94), Elida Gibbs(C-317/94), Kuwait Petroleum (C-48/97), Astra Zeneca (C-40/09) and Lebara (C-520/10).

The changes

In June 2016 the European Council adopted changes to the PVD which Member States are required to implement by 31st December 2018.

The proposals comprise the requirements to ensure certain and uniform treatment, to be consistent with the principles of a general tax on consumption exactly proportional to the price of the goods or services and to avoid inconsistencies, distortion of competition, double and non-taxation and to reduce the risks of avoidance. The proposals are intended to prevent these problems arising in the circumstances in which goods and services are paid for by vouchers.

The main effect of the changes when implemented is to create a consistent VAT treatment for single purpose and multi-purpose vouchers. Postage stamps, transport tickets and money-off type coupons entitling the holder to a discount are not within the scope of the changes.

Single purpose vouchers

Where the VAT treatment attributable to the underlying supply (place of supply and the VAT due) can be determined with certainty upon issue of a single-purpose voucher, VAT should be charged on issue and at any subsequent transfer of the voucher. The actual handing over of the goods or the provision of the services is not regarded as a separate transaction.

Multi-purpose vouchers

For multi-purpose vouchers (voucher which are not single-purpose vouchers) VAT shall be charged when the goods or services to which the voucher relates are supplied, and any prior transfer should not be subject to VAT. The fact that vouchers may be used in several member states each of which has different VAT rates is accommodated in the deferral of the chargeability to VAT until the time of redemption. Any separate supply of services such as distribution or promotion of the vouchers will be subject to VAT.

Scenarios affected

Telecoms

Vouchers used for supplies of telecommunication are the most popular type of voucher and are expected to fall into the treatment laid down for single purpose vouchers (SPVs). However, the possibility that a pre-paid telecom voucher can be used to make a phone call to a non EU destination, which would not generally be subject to EU VAT, could theoretically allow such vouchers to fall within the definition of a multi-purpose voucher whose ultimate use cannot be determined at the time of issue.

Retail Gift Vouchers

Vouchers issued by retailers who supply goods and services with a range of liabilities and places of supply are incapable of having the VAT liability determined at the time of issue and will fall to be treated as MPVs The actual handing over of the goods or the provision of services in return for the MPV as consideration will be subject to VAT on the face value of the voucher unless the actual amount previously paid is known.

It is common for both types of vouchers to be sold through supply chains involving intermediaries who will sell vouchers as disclosed agents acting on their own account and in some cases determining the onward sales price of fixed value vouchers. Under the proposals, the onward sale of a SPV will be subject to VAT, whereas for MPVs any intermediary will not be required to account for VAT except on any separately identified supply of services.

Question 7

Under Art 187 PVD the input tax incurred in relation to the purchase or acquisition of immovable property acquired as "Capital Goods" shall be subject to adjustment over a 5 to 20 year period according to the extent to which use of the asset is taxable.

Member States are provided with some discretion which allows them to elect for adjustment intervals between 5 and 20 years for immoveable property and to apply 5 years if electing for other Capital Items to be subject to adjustment.

Capital goods within the meaning of this legislation are subject to definition by each member state.

If an asset subject to the legislation is disposed of before the end of the adjustment period the taxpayer is required to make an adjustment based on the assumption that the use in any remaining intervals would have been of the same liability as the disposal. Art 188 PVD.

It is possible for property refurbishments to themselves result in capital goods in addition to the primary asset, in such case there may be more than one capital good and adjustment period applying to related assets at any one time.

Year 1

The office block cost €200m +€50m VAT = €250m

Taxable use in Year 1 is 80% and the recoverable VAT for that year would be:

€50m VAT x 80% taxable use. = €40m recoverable VAT

Year 3 adjustment

€50m VAT x (80% – 55%)/10 = €1.25m disallowed VAT

Year 5

No adjustment for Year 5 use as same extent of taxable use as in Year 1 (80%)

Adjustment for remaining Years (intervals) 6 -10 = 5 years)

€50m x (80%-100%) * 5/10 = €5m recoverable VAT