

The VAT package

Major changes to VAT from 1 January 2010

The European Council has published a new package of measures (known as the VAT Package) setting out significant changes to the rules on the place of supply of cross-border services. The package, published on February 12, 2009, is designed to ensure that VAT on supplies of services is borne in the member state where consumed.

The current "basic rule" that the place of supply of services is where the supplier belongs arguably no longer allows the VAT system to uphold that principle - the globalization of business and technology increase the ease with which services may be supplied at a distance.

Currently, depending on the nature of their service, service providers may choose to locate outside the EU and not charge VAT, or locate in the member states with a low rate of VAT and charge VAT at that rate, no matter which member state their customers are in. A stated aim of the new package is to produce a more level playing field between service providers.

All businesses which supply or receive cross-border services will need to assess how the new rules impact them and what, if any, action they can take to mitigate adverse effects or take advantage of new opportunities. At the very least, businesses will need to ensure that they are in a position to comply with the new rules, both charging VAT correctly and fulfilling new reporting requirements. Even this could entail a substantial amount of work to internal systems.

In the UK, a new behaviour based penalty regime has been introduced for incorrect VAT returns, with the consequence that unpaid VAT resulting from a "failure to take reasonable care" could attract penalties of up to 30 percent of the VAT liability.

At the same time as adopting the new rules on place of supply, the European Council adopted new measures designed to speed up the VAT refund process for traders established in other member states under the Eighth Directive (i.e., the process under which businesses established in one member state can reclaim VAT incurred in another member state).

On 22 December 2008, HM Revenue & Customs in the UK published draft legislation and initial guidance covering the changes to the place of supply rules and EC sales list requirements for services which take effect between 1 January 2010 and 1 January 2013. Further guidance is promised on key areas of uncertainty, although it is unlikely all matters will be resolved before the end of 2009. The UK legislation implementing these changes formed part of Finance Act 2009.

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Overview of VAT Package

New obligations

From January 1, 2010, service providers will have to file customer lists, quarterly or monthly, giving the VAT registration number of their cross-border customers and the value of the supplies they have made which are subject to the reverse-charge rule (see further below).

Place of supply

From January 1, 2010, the general rule for business-to-business (B2B) cross-border supplies will be that the place of supply will be the place where the customer is established and the recipient of the service will be obliged to account for the VAT relating to the service in its jurisdiction (i.e., apply the reverse charge procedure). The general rule for business-to-consumer (B2C) cross-border supplies will remain that the place of supply will be where the supplier is established. In both cases, these rules are overridden in favour of the location of a fixed establishment, if that is the actual recipient or provider of the services. (See further below.)

There will, however, be exceptions for services connected with land, supplies of passenger transport, supplies of services relating to cultural, artistic, sporting, scientific, educational, entertainment and other similar activities, restaurant and catering services and short-term leasing of means of transport. Generally, these supplies take place where they are physically carried out; supplies "relating to land" take place where the land is situated, as now, and the scope of this rule is extended. Supplies of hotel accommodation are now included, and it is arguable that travel agents' services will now, in certain cases, "relate to land." If so, travel agents would be obliged to register in a number of EU member states.

In the case of B2C supplies, there will be exceptions for supplies by intermediaries, supplies of transporting goods, ancillary transport activities, valuations of and work on moveable assets and supplies of intangible and electronic services. Supplies by intermediaries remain the place where the underlying transactions take place.

From January 1, 2011, the rules applicable to events will change (i.e., from those put in place in 2010) and the B2B (not B2C) supply of organizing events will be subject to the general rule—that is, VAT is accounted for at the place where the customer is established. This will not apply to the supply of admission to events. Cross-border B2B training will become subject to the reverse charge.

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From January 1, 2013, the rules applicable to leasing and hiring transport vehicles to non-business customers (other than short term) will change (from those to be put in place in 2010), with the result that the place of supply shall be where the customer is established or resident.

From January 1, 2015, the rules applicable to digitized services supplied at a distance will change. Electronic, telecom and broadcasting services will be deemed to be supplied where the customer is established, has his usual address or is resident (whether the customer is a business or a consumer); the same rules will apply alike to non-EU service providers and EU service providers. (Note that electronically supplied services cover services with Internet content, not merely communication by email.) Non-EU service providers supplying telecom, radio and television and broadcasting services to non-taxable persons resident in the EU will be able to register in a single member state of their choice, as now (a mini one-stop-shop arrangement), and the VAT charged will be at the rate applicable to the member state of the customer. EU-based providers of electronically supplied services, telecom, radio and television broadcasting services to consumers will also be able to fulfil all their VAT obligations in their member state, but the VAT rate charged will again be that applicable to the member state of the customers.

Each member state has the right to change the place of supply to the place of effective use and enjoyment to prevent double taxation, non-taxation or distortion of competition. Consistent and clear guidance is needed on the way this power will be exercised EU wide.

Key Points

- Increased administrative work due to increased reporting requirements;

Businesses need to analyze the impact of the changes on their particular circumstances and to put in place the procedures and systems that will make them compliant with the new rules.

It may not always be easy to determine whether the reverse charge procedure applies, given that the new place of supply rules will need to be implemented separately by each member state. For example, determining the "fixed establishment" or establishments (new article 44 of the VAT Directive) of a customer may mean determining whether services are being supplied to one or more establishments of the customer in different member states and whether a supply can be split and delivered to two or more establishments—that is, whether there is one supply or multiple supplies. Different jurisdictions may take different approaches on whether a supply should be treated as being made in their jurisdiction. Those involved with global contracts will need to review their arrangements as soon as possible.

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- So far as the establishment of the supplier is concerned, a new Article 192A abolishes the "force of attraction" interpretation of the law, and makes it clear that when a supplier of a cross-border service has a branch in the member state where the customer is based and that branch "does not intervene in that supply," then that branch is to be disregarded. In the UK, HM Revenue & Customs has said that, in its view, intervening would require "an active, significant role in the making of the supply," but that it will seek to ensure that there is guidance issued at EC level and that the test is applied consistently.
- Businesses receiving services from another member state will need to analyze, in the light of the new rules, whether they are now under an obligation to operate the reverse charge. The definition of a taxable person who must operate the reverse charge covers partly taxable persons—that is, persons also carrying out non-business activities—but it is at the moment unclear whether a passive holding company not VAT grouped with taxable traders, or indeed a business trading below the applicable VAT registration threshold, would be required to operate the reverse charge. It appears that a business receiving a supply for personal use (as opposed to non-business use) would be treated as a consumer. Suppliers will need to obtain customers' VAT registration numbers as the primary evidence of EU customers being in business, and guidance will be published detailing the checks it would be reasonable for suppliers to make. Alternative evidence, in particular in relation to non-EU business, will be acceptable.
- As well as being an administrative burden, the shift in the place of supply of services could for some give rise to a real VAT cost. Businesses which cannot recover all of their VAT may find that they suffer a cost when services which they used to buy VAT free from providers outside the EU, or at a low VAT rate from a provider established in Luxembourg or Malta, now carry a VAT cost because the reverse charge rule applies. Affected businesses include banks and insurance companies who outsource back-office services to non-EU-based providers. Businesses may, as a result of the operation of the reverse charge, have to register for VAT for the first time.
- For those whose services will in future be subject to the reverse charge procedure, the resulting decrease in the need for Eighth Directive refund applications should alleviate the cash-flow and administrative costs associated with the refund procedure. VAT is simply accounted for on the VAT return. The rules are changing on the time of supply of the reverse charge: instead of the payment date being critical, the time of supply will be the earlier of when the service is completed or when payment is made. In addition, in relation to continuous supplies of services, the time of supply will be linked to payment periods; but if no payment is made or invoice issued within a 12-month period, there will

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be a deemed supply at the end of the calendar year. These rules will apply for the purposes of determining the appropriate recapitulative statement too.

Quarterly or Monthly Sales Lists (Recapitulative Statements)

As noted already, businesses will need to put in place systems to identify when a service is being supplied to a VAT-registered EU business, to which the reverse charge procedure applies in the customer's jurisdiction, then capture the required data in time to be filed under what is essentially an extension of the EC sales lists system. The requirement does not apply to exempt financial transactions although because of the discrepancies in the financial services exemption across EU member states it is hoped that pragmatic guidance will be put in place. Businesses supplying IT services internationally and financial services are likely to be the most affected.

When a customer is in business but does not have a VAT registration number, the service must be omitted from the form. In the UK, ESLs relating to services may be submitted quarterly in relation to calendar quarters, and the same list can be used for both services and goods. In the UK, the list must be filed 14 days after the end of the relevant quarter, 21 days if submitted electronically, via a government gateway. Penalties will be imposed for delayed submission of forms or failure to deliver forms. Clearly businesses need to concentrate on ensuring that systems are ready in time.

Reform of Eighth Directive Input VAT Claims

Claims for VAT incurred in member states where the trader is not established will be made via an electronic portal to the trader's member state of establishment, and the details will then be passed on to the member states of refund. Claims must be made by September 30 of the calendar year following the refund period and must be for more than three months and less than a year.

Payment by the relevant member state must be made within four months of receipt and within 10 days of approval, and interest is due if payment is late, unless requested information fails to be supplied. The conditions for deduction (including blocked items) are those applicable to the member state of refund, but partial exemption restrictions of the claimant's own member state also apply.

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Summary

The overall aim of the VAT Package is to ensure that supplies of services are taxed in the place of consumption, as has indeed always been the aim of the VAT system. The broader application of the reverse charge mechanism should have the effect of lowering cash-flow costs in B2B transactions although, overall, the changes of the VAT Package will trigger additional costs, not least because of the phased implementation of the changes.

Businesses involved with cross-border or global contracts should review them to ensure that the impact of the new regime is understood and agreed to in the contracts and that any uncertainties are ironed out.

The new "fixed establishment" rules and the new "effective use and enjoyment" rules bring with them risks of double taxation or non-taxation, especially if they are not implemented consistently across the member states. Businesses require consistency across the EU for the new regime to be workable, and much discussion and agreement across member states needs to take place. There is no double tax relief for VAT and no formal mechanism for EU member states to agree to differences in treatment which affect a taxpayer. It is likely that mechanisms of this kind may need to be developed if disputes take place regularly.

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