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THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

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MODULE 3.02 – EU VAT OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Finance Director
Rialto Ltd
Bordonia
EU

12 June 2020

Dear Sir or Madam

VAT aspects of your business

I am pleased to provide a review of the EU VAT aspects of your business and advise you that the VAT treatment of each of your activities is as follows:

Importation of axle assemblies from Turkey

The importation of axle assemblies from Turkey, which is outside the EU, into Bordonia will require Customs entry and the payment of Customs duty and VAT. These will be calculated with reference to the purchase price of the imported goods with the addition of freight, insurance and any other incidental costs related to the transportation of the goods from the place of shipment to the point of entry into the EU.

Import VAT will be charged at the same rate as applied to domestic sales of identical goods within Bordonia and will be recoverable in full against the subsequent taxable supplies of complete assembled tractors. It may be possible to defer the payment of duty and VAT by using a deferment account which will assist cash flow by allowing imported goods to be released from Customs controls before Rialto is required to make periodic payment to the customs authority for duty and VAT.

Components obtained from EU suppliers, incl “Call Off” stocks

Component parts obtained from EU suppliers will be subject to acquisition tax in Bordonia, this will include goods provided from the factory in Estaria as well as goods purchased from third party suppliers established in other member states. Acquisition tax needs to be calculated based on the value of goods purchased and entered on the Rialto Ltd VAT return as both Output tax and Input tax since it will be fully recoverable against subsequent taxable supplies of completed tractors.

In common with goods from third party suppliers, the movement of Rialto’s “own goods” between Estaria and Bordonia will require evidence of removal from Estaria as well Rialto’s Bordonia VAT number being shown on the relevant invoice. Since 1.1.2020, in order to claim exemption on their intra-community sales, the vendors must hold two non-contradictory pieces of evidence to show that the goods have been despatched to and have arrived in Bordonia.

Since 1.1.2020 suppliers may provide “call –off” stocks of components under a simplified procedure if they satisfy specific rules contained in Arts17a, 243 and 262(2) PVD and Art 54a IR The simplification means that there is no intra-community supply or intra-community acquisition when the goods are transported to the call-off stock in the acquirer’s country as these will be recognised and accounted for only when the acquirer eventually takes ownership of the goods.

The requirements are that the acquirer uses the goods within 12 months of arrival. In addition, the supplier must not be VAT registered in Bordonia and both supplier and recipient businesses must keep registers of all goods despatched and received on these terms. Furthermore, the vendor must record the VAT number of the intended acquirer of the call-off stock in his recapitulative statement. The despatch and the acquisition must eventually be accounted for in

the VAT records of the vendor and the acquirer when title to the call-off stock goods passes to the acquirer.

Consignment stock (other than call-off stock)

Component suppliers established in other member states who choose to provide consignment stock available for Rialto and other customers will be required to register for VAT in Bordonia (and Estaria if applicable) and treat the movement of their goods as an acquisition and subsequent sale on which domestic VAT will need to be charged. This arrangement did not change on 1.1.2020.

Tractors sales to non-EU and EU customers

Tractors sold for export to customers in the USA may be sold without VAT providing sufficient proof of export from the EU is held and the goods are removed from the EU within 3 months of sale Art 146 PVD.

Sales made to business customers established in the EU will require evidence of removal from Bordonia, the VAT registration number of the customer in the member state to which the tractors are removed must be shown on the sales invoice and the transaction must be reported on an EC Sales List, or recapitulative statement. Since 1.1.2020 there must also be two items of non-contradictory evidence held by the supplier showing that the goods have arrived in the customer's member state.

Domestic sales will be liable to the VAT rate applicable in Bordonia and will require a VAT invoice to be issued.

I trust that I have been able to address all of the points you have raised but please do not hesitate to contact me if you require anything further.

Yours faithfully
ADIT Student

Question 2

CFO
Tomcom SA
Mestria
EU

12 June 2020

Dear Sir or Madam

Report on VAT aspects of your drone business

I am pleased to provide my report of the EU VAT aspects of your drone sale and hire business in reply to your request for identification of all relevant VAT aspects including the place of supply.

Sale of Drones

The sale of drones is regarded as a supply of goods normally made where the goods are located at the time that title passes from you to your customer. However, special rules apply in cases where supplies are made to non–taxable persons belonging in other member states of the EU and the goods are despatched by or on behalf of the supplier. The arrangements are described as "Distance Selling" and require you (the supplier) to register for VAT in each country to which you send goods if sales to that country in a calendar year exceed either €35,000 or €100,000 according to the threshold set by the member state concerned.

You will need to keep a record of your sales for each member state to which you send goods so that you can take timely action to register if required. Until such time as you reach the relevant threshold you should charge Mestria VAT to your overseas non-business customers.

The distance selling rules only apply to sales made to non-taxable persons and sales made to EU business customers can be made without VAT being charged subject to the conditions that you have been provided with your business customer's VAT registration number and display it on your invoice, as well as completing EC Sales Lists/Recapitulative statements and hold evidence that the goods have left Mestria. Acquisition tax will need to be accounted for by your customer in their member state and there may be Intrastat requirements.

Drone Hire

Drone Hire is a supply of services for which the place of supply to a non-taxable person is determined under Art 45 PVD and will be Mestria where you the supplier are established – you will therefore need to charge Mestria VAT. If your customer is in business in another member state your supply can be treated under the reverse charge arrangements, although you must hold evidence that your customer is in business. A VAT registration number issued by their host tax administration is probably the most accessible evidence to indicate that your customer is in business. You will also need to complete EC Sales Lists for these supplies.

The position of drone hire with an operative does not differ from the VAT treatment solely of a drone and so there is no additional complication if you provide an operative (although I realise you will charge more).

Training

On-line training for owners and hirers made available through electronic devices at additional cost will in the case of non-taxable customers fall within the special rules at Art 58 PVD and Annex II. These rules require you to either register in each member state in which your customers belong, or adopt the MOSS scheme registration which enables you to make a single return through your host tax authority, accounting for all VAT amounts due from on-line training supplies made to customers across several member states.

“Live” training involving interaction with a human can’t be dealt with as an electronically supplied service due to IR Art 7 and Point 5(a) of Annex I to IR which only allows services with no or limited human intervention. In these cases, the place of supply will be determined by Art 45 PVD and will be Mestria, being the place where the supplier is established. This means that you will have to charge Mestria VAT.

Supplies of training to business customers in other member states will be subject to reverse charge procedures and will not require VAT to be accounted for by Tomcom.

I trust that I have been able to address all of the points you have raised but please do not hesitate to contact me if you require anything further.

Yours faithfully
ADIT Student

PART B

Question 3

The primary theme which characterised the earliest referrals to the CJEU concerned whether the holding and disposal of shares was an economic activity or not and considered passive and active management of investments.

This point was considered in cases such as BLP C- 4/94 which was concerned with whether a "look through" could be taken to the ultimate activities funded by a share sale or as the court found a transaction that resulted in an exempt supply (share sale) could not be ignored when considering input tax recovery. Also Polysar C- 60/90 in which it was held that the mere holding of shares without a direct or indirect involvement in the management of the underlying investment does not entitle the shareholder to the status of a taxable person and therefore there is no right to input tax recovery.

Active management was an important feature of Cibo Participations SA C16/00 in which a holding company reclaimed input tax in relation to the purchase of subsidiaries and was actively involved in managing its group. The CJEU held that the management could qualify as economic activity "if it involved the performance of administrative, financial, commercial or technical services". This departed from the finding in Polysar although the ruling maintained that the receipt of dividends remained outside the scope of VAT.

A similar finding concerned AB SKF C-29/08 in which the disposal of shares was viewed by the court as being similar to the disposal of a business as a transfer of assets as a going concern (Art 19 PVD may be elected by member states) and that it may be possible for the component costs to relate to the overheads of the whole of the holding company's activities, and therefore recoverable. In common with other cases the holding company had supplied services subject to VAT to its shareholdings before disposal and this feature appears to have favourably influenced the court.

Larentia & Minerva C-108/14 was concerned with the extent to which VAT incurred on fees relating to an acquisition of subsidiaries could be recovered and whether it should be attributable to non-business investment activities. The court held that where the holding company involves itself in the management of the subsidiaries it carries out economic activities and the VAT on costs forms part of general expenditure recoverable in full in the absence of exempt activity. In contrast, if the holding company involves itself in the management of only some of its subsidiaries it was held that the VAT incurred could only belong in part to the general overheads and only that proportion which related to the economic activities i.e. active management can be recovered.

MVM C-28/16 continues the trend of allowing the holding of shares to be viewed as economic activities if accompanied by active management on which VAT was charged, however in this case the holding company failed to raise a charge before the disposal and the court determined that they could not be seen as conducting economic activities and so were unable to recover input tax relating to the disposals.

PART C

Question 4

The amount of VAT due on a supply must be proportionate to the price of the goods or services (consideration for the supply) and depends on the rate of VAT in force at the time of supply (Art 2 PVD). Art 73 PVD states that the taxable amount shall "include everything which constitutes consideration obtained or to be obtained by the supplier, in return for the supply, from the customer or a third party, including subsidies directly linked to the price of the supply".

The taxable amount shall exclude the VAT itself – Art 78 PVD, but shall include taxes, duties, levies and incidental expenses such as commission, packing, transport etc. charged by the supplier to the customer.

In a limited range of circumstances designed to prevent evasion or avoidance, the Open Market Value (OMV) shall be used as the taxable amount instead of the actual consideration – Art 80 PVD. These circumstances include transactions between related parties where there is limited recovery of input tax by the recipient or in some cases the supplier.

Circumstances in which a business may receive and retain a payment without creating a liability to account for VAT include:

- Deposit taken for the satisfactory return of hired goods;
- Deposit held pending satisfactory completion of work e.g. a Bond;
- Prize money;
- Donations freely given for example see the CJEU case of Tolsma C-16/93;
- Insurance payments for compensation under a contract of Insurance;
- Compensation payments for the failure by a third party to perform agreed works; and
- Other receipts which are not by way of business.

Question 5

Legitimate expectation

The EU doctrine of Legitimate Expectation (LE) applies more widely than taxation and has been considered in some notable CJEU cases as well as in domestic courts. The term refers to the reliance that a taxpayer may place upon the known position of a tax authority through its legislation, policy or guidance. Taxpayers have an entitlement to place confidence in understanding the treatment that may reasonably apply to their circumstances in advance of undertaking transactions. However there are limits to what constitutes a legitimate expectation and generally cases have been taken to the CJEU by taxpayers who have perceived that their entitlement to LE has been breached.

In the CJEU case of Gemeente Leusden C-487/01 the court found that the tax authority had not breached the taxpayer's legitimate expectation when withdrawing the right to opt to tax lettings of immovable property, however it opined that the authority must take account of legitimate expectation when determining the implementation of legislative amendment. The repeal of a law from which the taxpayer had previously derived an advantage by paying less tax was found not to constitute a breach of legitimate expectation.

In Schlobstrafe Gbr C-396/98 the CJEU ruled that a taxable person's right to deduct VAT paid in advance of making letting supplies where it had elected to waive exemption is retained where a legislative amendment retrospectively removed the possibility of making an election. The principle of legitimate expectation meant that the taxpayer could not be deprived retrospectively of the right to deduction by a change in law post-dating the purchased supplies, but before the commencement of letting, depriving the taxable person of the right to waive exemption.

In Marks & Spencer plc C-62/00 the CJEU found that national legislation retroactively curtailing the period within which repayment of VAT may be claimed was in breach of the principles of effectiveness and of the protection of legitimate expectation. A similar conclusion was reached in Sudholz C-17/01 where it was held that part of legislation introduced in Germany which allowed for a change of tax treatment retrospectively to the detriment of a taxpayer was invalid. Also see Grundig Italiana SpA C-255/00, Stichting Goed Wonen C-326/99 and others.

Unjust enrichment

The CJEU confirmed at an early stage that a taxpayer is entitled to claim a refund of taxes levied in breach of EU law but that a Member State is entitled to refuse repayment if, as a result, the taxpayer would become unjustly enriched - see for example Hans Just (Case C-68/79).

The concept of Unjust Enrichment largely stems from tax authorities seeking to reject or limit claims for repayment of incorrectly levied taxes in circumstances where the claimant has not borne the imposition of the tax because he has passed it on to a third party – see for example San Giorgio (Case C-199/82). In Comateb & others C-192/55 the CJEU gave a ruling on the rights of businesses to recover overpaid taxes – although this was not a VAT case the principles have also been applied to later VAT cases. In this case the CJEU confirmed that unjust enrichment of a claimant was a justifiable reason to refuse repayment, but only when the tax had been borne by someone else.

This introduces the concept of when tax is "passed on" and has inevitably led into looking at the economics of transactions and pricing. The court found that even if the taxpayer had indirectly suffered loss of trade by being less competitive than those selling similar products there would not be unjust enrichment by repaying some tax to the claimant.

The concept was considered again in Marks & Spencer plc C-309/06 where the CJEU ruled against discrimination on the grounds that payment businesses but not repayment business

could submit claims for wrongly charged VAT – and by extension only the former could be subject to claims of unjust enrichment, even though businesses of both types may be in competition selling similar goods.

Dilexport Srl C-343/96 considered a similar point referred from Italy and concluded unjust enrichment is a defence for the state to prove and not for the claimant to disprove.

In its decision in Lady & Kid (Case C-398/09), the CJEU restated the fundamental principle that the defence of unjust enrichment (not to repay incorrectly levied taxes) was restricted to cases where the tax has been passed on, for example by increasing the price to the customer. Paragraph 25 of the judgment states "…the direct passing on of the tax wrongly levied to the purchaser constitutes the sole exception to the right to reimbursement of tax levied in breach of European Union law"

In Alakor Gabonatermelo es Forgalmazo Kft C-191/12 a Hungarian case, the CJEU ruled that repayment of VAT could not be refused on the grounds that a project had been part funded by state grant. However, it rules the state was not precluded from refusing repayment provided that the economic burden relating to the refusal to allow deduction had been completely neutralised. The matter was referred back to the national courts to decide.

This application of unjust enrichment to an input tax claim is unusual.

Question 6

The correct VAT treatment of supplies of goods made on the river cruise from Bordonia to Esteria is determined by particular rules relating to supplies made on an intra-community "passenger transport operation". These rules are set out at Art 37 PVD which deems the place of supply to be the point of departure of the passenger transport operation. IR Art 15 clarifies that it is the point of departure of the vessel and not the passenger making the purchase which determines the place of supply.

Sales made to passengers will normally be liable to Bordonia VAT rates. In the case of purchases by non-EU travellers it is possible that, subject to member state value limits, they may purchase goods on which EU VAT is not charged if they are eligible travellers falling within the scope of Art 147. Removal of any relevant goods from the EU must occur with 3 months of purchase and requires production of the invoice or similar document to Customs at the point of departure from the EU.

Spa and massage services provided on board by a USA established business may be considered to be entertainment and similar services within the scope of Art 54 PVD and would be regarded as being subject to VAT according in the place where those activities take place. In practice this could require the USA established business to register and account for VAT in each of the member states through which the river cruise passes. Following the CJEU Schmelz case C- 97/09 the USA business would not be able to take advantage of any VAT registration threshold in any member state and consequently would need to charge VAT on all sales made according to the member state in whose waters the cruise passes and in which the activities take place.

Restaurant and catering services supplied on intra-community passenger transport fall under Art 57 PVD which requires VAT to be charged according to the member state of departure, in this case Bordonia. It is not relevant that the supplier is established in Italy.

d) The VAT treatment of goods sold for consumption on board the vessel is subject to member states exercising the option under Art 37(3) PVD which allows them to treat the supply as exempt from VAT with deduction. It therefore depends if Bordonia has exercised this option pending the resolution of the treatment of such supplies at EU level.

Question 7

A taxable person who makes taxable as well as exempt supplies may be described as being Partly Exempt and be required to restrict input tax recovery to ensure that only VAT incurred on those supplies used to make onward supplies with recovery can be credited.

One of the consequences of being Partly Exempt is a restriction on input tax recovery according to the use to which supplies are used or intended to be used.

Art 174 PVD provides a method for the calculation of the recoverable proportion of input tax attributable to both exempt and taxable supplies. The method in Art 174 is determined by a fraction comprising the value of turnover with recovery as the numerator; and the value of turnover with recovery plus turnover for which recovery is not available as the denominator – the result to be expressed as a percentage and rounded up to the next whole number. Specific turnover values can be excluded from the calculation, for example, incidental real estate and financial transactions and sale of capital goods.

As an alternative to the method detailed in Art 174 above, member states may allow a sectorised method under Art 173(2), which can be based on an alternative calculation such as the numbers of transactions, headcount, time used etc. Sectorised methods are expected to be based on parts of the business for which separate accounts are maintained.

Art 173(2) PVD allows for insignificant amounts of VAT attributable to exempt supplies to be deductible and has resulted in member states having “de minimis” levels of input tax which can be recovered without restriction. The partial exemption position is determined annually and may result in a provisional calculation each quarter in the following year with an annual adjustment being required to determine the final amount of recoverable VAT.

CJEU case law includes Sofitam C-333/91 which was concerned with whether share dividends should be included in the denominator figure applicable under Art 174 and Mercedes Benz Italia SpA C-378/15 which considered whether exempt income from loans was ancillary to the supply of vehicles and whether the Italian tax authority should provide a method which allowed “use” to be considered rather than a single value based calculation for the whole business.

Volkswagen Financial Services (UK) Ltd C-153/17 considered whether the inclusion of general overhead costs relating to vehicle financing which were included in the interest (exempt) charge should be considered as part of the vehicle (taxable supply). The court found that they should and that member states may not exclude the value of the taxable supply from such methods.

Disposals of goods on which input tax has been partly restricted due to partial exemption remain subject to output tax on their full selling price.