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Contribution of articles

The editors welcome original and previously unpublished contributions, which will be of interest to an international readership of tax professionals, lawyers, executives and scholars. Manuscripts will be subject to a review procedure and the editors reserve the right to make amendments which may be appropriate prior to publication. Manuscripts should be sent with a covering letter submitting biographical data and current affiliation to the editors, Fabiola Anonnacondia and Walter van der Corput, at the address on this page. The author will be notified of acceptance, rejection or need for revision within eight weeks. VAT News contributions will only be acknowledged by publication and an indication of the author’s name and affiliation. Articles may range from, preferably, 2,000 to 5,000 words. Additional information may be obtained from the editors, e-mail: VATMonitor@ibfd.org.
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Abuse of EU VAT Law – Dr Joep J.P. Swinkels

In 2006, the Court of Justice of the European Union (ECJ) extended the doctrine of abuse of law to the area of VAT. The doctrine has the effect that, under specific circumstances, the tax authorities must ignore artificial transactions carried out in the framework of VAT-saving schemes. In this article, the author discusses the concepts of “tax advantage” and “tax advantages contrary to the purpose of VAT law”. The author concludes that there is a certain tension between, on the one hand, the principle of abuse of law and, on the other hand, the EU principle of legal certainty and the freedom for businesses to structure their activities so as to limit their tax liabilities.

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Technology Can Solve MTIC Fraud – 3 and Final – Richard Ainsworth

In his recent article “Technology Can Solve MTIC Fraud – VLN, RTvat, D-VAT certification”, Richard Ainsworth discussed the three main options that claim to be capable of resolving missing-trader VAT fraud, and concluded that real-time VAT collection (RTvat) is the only solution that is actually capable of preventing that type of fraud and limiting several other forms of fraud. In this follow-up article, Chris Williams briefly responds to Richard Ainsworth’s reservations as regards the central auditing function that forms part of RTvat’s proposal for real-time VAT collection. Richard Ainsworth has the final word in this discussion on the merits of real-time VAT collection in general and RTvat in particular.

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A New Defence for Victims of EU Missing-Trader Fraud? – Christian Amand and Kris Boucquez

The downside of the system of fractionated remittance of VAT is that it makes the VAT system vulnerable to missing-trader fraud. Despite all anti-fraud measures that have already been taken in the European Union, the phenomenon of missing traders seems not to be under control. However, the accumulated anti-fraud measures and practices of the tax authorities have resulted in unacceptably high compliance burdens and uncertainty for the business community. In this article, the authors explain that newly available legal and technological means could make the burdens of the VAT system on EU businesses proportionate again. If Member States would make full use of its potential, Eurofisc could play a crucial role in the process of restoring the proportionality of the EU VAT system. If necessary, the ECJ could push Member States into the right direction.

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Towards a Simpler, More Robust and Efficient VAT System by Levying VAT at EU Level – Kenneth Vyncke, Axel Cordewener and Luc De Broe

At the end of 2010, the European Commission launched a public debate on the future of the EU VAT system. In this article, the authors explain that conversion of the VAT system into a true EU tax is the most appropriate approach. The description of their proposed EU VAT system does not pretend to be complete but gives a good general idea of the authors’ approach. Even if it appears that adoption of the proposed EU VAT system is not possible for political or practical reasons, specific elements of the authors’ proposal are still of use.

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Unjust Enrichment under EU VAT – Dr Joep J.P. Swinkels

Under the principle of unjust enrichment, Member States may refuse to repay indirect taxes to traders on the ground that they have already shifted the burden of the tax to a third party and would be unjustly enriched by receiving the tax from the tax authorities. In a large number of judgments, the ECJ has described the terms and conditions under which Member States may apply the principle of unjust enrichment. In this article, the author explains that those conditions are significantly different depending on whether the tax refund concerns a tax that Member States imposed in violation of EU law or VAT charged by a trader to his customer by mistake.
When GST was introduced in Australia, it was supposed to be simpler than the wholesale sales tax it replaced. However, almost 11 years after the introduction of the simpler tax, there are still areas in the GST system that lack clarity, for example, the issue of how much vacant land should be regarded as “residential premises” for GST purposes. In this article, the author discusses the background of this issue and various options to resolve the problem.
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Court of Justice – 2011-1

The biannual overview of ECJ VAT cases, which contains the operative parts of the judgments delivered by the Court of Justice of the European Union in VAT cases from 1970 and an overview of the VAT cases pending before the ECJ, has been updated to include the information available up to 31 July 2011.

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The Editors
Administrative Burdens on Cross-Border B2B Services under EU VAT

Under Directive 2008/8, new rules for determining, for VAT purposes, the place of supply of services, and various related measures entered into force in the European Union on 1 January 2010. Although, at first sight, they appear more business-friendly than the former arrangements, the new place-of-supply rules gave immediate rise to many practical questions, which could not be answered at that time. One and a half year later, many of those questions have been answered by means of a new Implementing Regulation.

Parts of the new provisions of the recast Implementing Regulation, such as the definitions of “fixed establishments” and the taxable person’s “main place of business”, do not contain much news because they are largely derived from judgements of the Court of Justice of the European Union.

Since many of the new VAT place-of-supply rules depend on whether the customer qualifies as a taxable or non-taxable person, and on the place where the customer is established, it is not surprising that the Implementing Regulation contains rules on the basis of which service providers may determine the VAT status of their customers and the place where they are established. For the purposes of establishing the customer’s VAT status, if the customer is established in the European Union, the Implementing Regulation requires service providers to check the validity of their customer’s VAT identification number through the VAT Information Exchange System (VIES). Checking the customer’s VAT status is more difficult where the customer is established outside the European Union because not all countries outside the European Union operate a database comparable to the VIES. Under those circumstances, service providers can check the VAT status of their customers on the basis of the certificate issued by the tax authorities competent for the customer confirming that, for the purposes of obtaining a refund of EU VAT under the Thirteenth Directive, the customer is engaged in economic activities. However, where an EU customer has not yet received a VAT identification number, but informs the service provider that he has applied for it, or where a non-EU customer does not possess a refund certificate, but has a VAT or similar number attributed to it by the tax authorities of the country of establishment, which is used to identify businesses, or provides any other proof which demonstrates that the customer qualifies as a taxable person, the service provider can also use such alternative forms of evidence to determine the VAT status of his customer, provided that the service provider carries out a “reasonable” level of verification of the accuracy of the information provided by the customer, by “normal” commercial security measures, such as those relating to identity or payment checks. The latter requirements are fairly vague and may in practice give rise to disputes as to what is a “reasonable level of verification” and what may be considered to be “normal commercial security measures”.

The onus of proof on the service provider as regards the customer’s VAT status seems to be straightforward if the customer is established in another Member State and has a valid VAT identification number issued by the tax authorities of that Member State. However, the simplicity of the situation is somewhat deceiving because the Implementing Regulation requires that the service provider must have obtained confirmation not only of the validity of that identification number, but also of the associated name and address, in accordance with Art. 31 of Regulation 904/2010. That latter provision however will enter into effect on 1 January 2012. Until that date, the VIES only confirms whether or not a specific VAT identification number is “valid” and, if that condition is fulfilled, does not provide further information as to the identity of the business to which the number has been assigned. In other words, the Implementing Regulation imposes a requirement that service providers cannot possibly comply with for the time being and may not be able to comply with from 2012 because the EU legislature tends to overestimate the capability of Member States to adapt the IT infrastructure to new requirements. There is no guarantee that the VIES will be equipped on time with the new feature that is required under Art. 31 of Regulation 904/2010, and that is necessary for service providers to establish the VAT status of their customers under the binding Implementing Regulation.

Even if, in the future, they are able to check the validity of their customers’ VAT identification numbers and the identity of the associated business, service providers will have to store the results of their check in their business records. In addition, in respect of cross-border services provided to businesses established in another Member State, service providers have to report the value of the services through their monthly recapitulative statements (EU sales lists). To that end, the service providers need the customer’s VAT identification number, and the Implementing Regulation does not provide further information.

* Member of the editorial board of the International VAT Monitor.

as to how service providers must comply with the latter obligation if their customer qualifies as a taxable person but does not yet have a VAT identification number. This aspect will become particularly sensitive if Member States decide to adopt the proposal under which the tax authorities can hold a supplier jointly and severally liable for payment of the VAT that the customer is legally required, but failed, to report on purchases in another Member State, if the supplier has not correctly reported the transaction through the recapitulative statement.

The provisions of the Implementing Regulation do not make it easy for service providers to conclude contracts for the provision of services with business customers established in another Member State and be certain of the VAT consequences. For each and every individual contract, even in the case of “regular customers”, service providers may have to do their homework before they can decide whether or not they must charge VAT to their non-resident business customer, and they must store the results of their homework for a large number of years. Although they are binding – also on the tax authorities of the Member States – the provisions of the Implementing Regulation leave the tax authorities far too much room to impose excessively burdensome administrative obligations on service providers engaged in the provision of cross-border B2B services. Imposition of more stringent administrative obligations is increasingly becoming a characteristic of the EU VAT system. The increased administrative obligations, also on honest businesses, do not only enable the tax authorities to impose penalties (which may be as high as 100% of the related VAT) for non-compliance, but also enable them to recover, from honest businesses, VAT losses that result from fraudulent or irregular activities of others.

The conclusion is that the tax authorities in the European Union are increasingly losing control of the VAT system and that honest businesses pay the price for it, in the best-case scenario, in the form of having to devote additional resources to compliance with their administrative VAT obligations.
Abuse of EU VAT Law

In 2006, the Court of Justice of the European Union (ECJ) extended the doctrine of abuse of law to the area of VAT. The doctrine has the effect that, under specific circumstances, the tax authorities must ignore artificial transactions carried out in the framework of VAT-saving schemes. In this article, the author discusses the concepts of “tax advantage” and “tax advantages contrary to the purpose of VAT law”. The author concludes that there is a certain tension between, on the one hand, the principle of abuse of law and, on the other hand, the EU principle of legal certainty and the freedom for businesses to structure their activities so as to limit their tax liabilities.

1. Introduction

Although the doctrine of abuse of EU law may have originated in 1974,1 it did not affect the field of taxation until 2000 and the field of VAT until 2006. In 1974, the Court of Justice of the European Union (ECJ) decided2 that the freedom to provide services does not prevent Member States from requiring that specific service providers have their habitual residence within the state, where that requirement is aimed at maintaining professional rules justified by the public good – in particular rules relating to organization, qualifications, professional ethics, supervision and liability – which are binding on service providers resident within the state in which the services are provided, and where, by being resident in another Member State, service providers would escape the ambit of those rules. The service provider in question represented his clients before national courts in the Netherlands in cases in which representation by an advocaat (licensed lawyer or barrister) was not obligatory. During proceedings before a national court, the representative had transferred his residence from the Netherlands to Belgium and his capacity to represent his client before that court was contested on the ground that Netherlands law provided that only persons established in the Netherlands had the right to act as legal representatives in court.

However, although in this case there was a direct link between the fact that the service provider had moved to another Member State and the loss of his qualification to represent his clients in court, the service provider’s change of residence would only qualify as abuse of law if, at least, his main reason for moving to Belgium was to escape the professional rules of conduct connected with acting as a legal representative in the Netherlands. The case file does not reveal any details as to the motives of the service provider for moving to Belgium. In this respect, it should be noted that many wealthier people resident in the Netherlands move their residence to Belgium, for various reasons.

2. VAT Avoidance Schemes

Although it has been confronted with a considerable number of schemes by which the parties involved aimed to escape national VAT legislation or rules applicable in certain Member States,3 the ECJ has been able to avoid the application of the doctrine of abuse of law for a long time. For example, the ECJ was confronted in 2004 with a university that had acquired a building, which it subsequently supplied4 to one of its subsidiaries (Centralan), and then had leased it back under the option for taxation. Two years later, Centralan granted a 999-year lease5 for GBP 6.37 million to another subsidiary of the university (Inhoco 546). The lease was exempt from VAT and, in order to prevent adjustment of the input tax it had initially deducted, Centralan also transferred, three days later, its residual ownership rights (“freehold reversion”) back to the university for a total amount of GBP 1,000 plus VAT.

The ECJ simply corrected the university’s VAT-saving scheme by declaring that, for the purposes of adjusting Centralan’s initial input tax deduction, the two inextricably linked transactions (exempt lease and taxed transfer of the freehold reversion) must be taken into account together.6 Since the consideration for the exempt lease (GBP 6.34 million) substantially exceeded the consideration for the taxed transfer of the freehold reversion

* Tax adviser, the Netherlands.

4. A “freehold” can be described as the right to occupy immovable property for an unlimited period. A “lease” is a leasehold interest, which amounts to the right to occupy immovable property for a defined period of time. There is no limit to the length of a lease, and leases for 999 years are common. It is possible for the owner of a freehold to grant a lease for a period of 999 years in return for a substantial premium with no, or very low, subsequent rental payments.
5. The owner of an unencumbered freehold in a building can grant a lease (in return for rent, a premium or a combination of the two) and then, by transferring the freehold reversion, grant the right to occupy the property on the expiry of the lease, together with the right to receive any rent due under the lease.
6. Inhoco also took over from Centralan the lease contract of the building with the university for the remaining part of the lease period, albeit that it had not opted for taxation.
7. Once the owner of a freehold has granted a lease, he no longer owns an “unencumbered freehold” but merely the “freehold reversion”, i.e. a residual interest in the property which equates to the right to occupy the property once the lease has expired and to receive the rent, if any, throughout the term of the lease. If the rent under the lease is very low and the lease period very long, the freehold reversion is of low value.
Joep J.P. Swinkels

(GBP 1,000), Centralan was required to repay to the tax authorities almost all input tax it had initially deducted, for the remaining part of the adjustment period.

RAL’s tax avoidance scheme, under which it shifted the place of establishment of the company, which operated gaming machines in the United Kingdom, from the territory of that Member State to one of the Channel Islands, i.e. to a place outside the European Union, under the assumption that its services were deemed to be supplied at the place where it had established its business, was stalled by the view of the ECJ that the services were “entertainment services” that are deemed to be supplied at the place where the services are physically performed.9

Finally, BUPA Hospital’s plan to avoid the adverse consequences for its right to deduct input tax of the fact that its services became subject to the VAT exemption for hospital care, by making an advance payment (of GBP 100 million) in respect of future supplies of drugs and prostheses by a connected party at the time its services were still zero rated, was torpedoed by the ECJ’s finding that the future supplies were insufficiently precisely determined to qualify the payments made by BUPA Hospital as “advance payments” that trigger the liability of VAT.10

However, the ECJ did not manage to find a rational solution for the tax avoidance schemes of Halifax and the University of Huddersfield without relying on the doctrine of abuse of law. Halifax was a financial institution whose rate of deduction was 5%. By means of a complex scheme involving three subsidiaries and a number of precisely timed transactions, Halifax thought that it had managed to avoid practically all non-deductible input tax on the construction of four call centres. Likewise, the University of Huddersfield, whose rate of deduction was also 5%, thought that it had reduced the non-deductible tax on the construction of two buildings by letting them back for a slightly higher rent.

15. Id., Para. 34. It should however be noted that, in the German version of the judgment, not the word “advantage”, but “Steuervorteil” (tax advantage) is used. In view of the translations of that paragraph into French (“avantage”), Spanish (“ventaja”), Italian (“vantaggio”) and Dutch (“voordeel”), it can safely be assumed that the German translation is incorrect.

3. Abuse of VAT Law

By its judgments in Halifax11 and University of Huddersfield,12 the ECJ declared that, where an abusive practice has been found to exist, the transactions involved must be redefined so as to re-establish the situation that would have prevailed in the absence of the transactions constituting that abusive practice.

A finding of an abusive practice requires that:

- the transactions concerned, notwithstanding formal application of the conditions laid down by the relevant provisions of the VAT Directive13 and the national legislation transposing it, result in the accrual of a tax advantage the grant of which would be contrary to the purpose of those provisions;

- it is also apparent from a number of objective factors that the essential aim of the transactions concerned is to obtain a tax advantage.

The ECJ concluded that to allow taxable persons to avoid or deduct all input VAT, even though, in the context of their normal commercial operations, they have no or a limited right to deduct input VAT, would be contrary to the principle of tax neutrality and, therefore, contrary to the purpose of the VAT Directive or the national rules transposing EU law into national law.

In its judgments, the ECJ observed that the fact that a given transaction is carried out for the sole purpose of obtaining a tax advantage is entirely irrelevant in determining whether it constitutes a supply of goods or services and an economic activity. The ECJ also declared that, where a trader has the choice between exempt and taxable transactions, the choice may be based on a range of factors, including tax considerations relating to the VAT system. In this context, the VAT Directive does not require him to choose the option which involves paying the highest amount of VAT. By contrast, businesses may choose to structure their activities so as to limit their tax liability. It should be noted that, in this context, the trader’s options were limited to applying the exemption for the supply or letting of immovable property or exercising the option for taxation of the exempt transactions.

In Weald Leasing,14 the ECJ added that a taxable person cannot be criticized for transforming the purchase of goods into a leasing transaction through a connected party, which has the advantage15 of spreading the burden of non-deductible VAT over a number of years, provided that the VAT on that leasing transaction is duly and fully paid. In this respect, the ECJ observed that resort to a leasing transaction does not automatically mean that the amount of VAT on that transaction will be less than what the customer would have paid if he had purchased the goods. In Weald Leasing, Churchill Management and its subsidiary Accident Repair Centre, whose rates of deduction were 1%, channelled their purchases of goods through another subsidiary, Weald Leasing, which subsequently leased them to Suas (an entity set up by Churchill Management’s VAT adviser and his wife), whereby Suas...
leased the goods to the actual users (Churchill Management and Accident Repair Centre).

However, the leasing transactions could be abusive if the rental fees were set at levels which were unusually low or did not reflect any economic reality and, by involving Suas, the parties had prevented the tax authorities from adjusting the artificially low price in accordance with the open-market value of the leasing transactions. In *Halifax, University of Huddersfield and Weald Leasing*, the schemes applied by the parties involved had the effect of reducing those parties’ non-deductible input tax. However, a practice can also be abusive if the direct tax advantage accrues to the taxable person’s customers. In *Part Service*, the lessor of vehicles had split up the lease contracts into two separate contracts between, on the one hand, the lessor (IFIM Leasing) and a connected party (Italservice/Part Service) and, on the other hand, the lessees. The first contract, which covered not much more than the lessor’s purchase price of the vehicle, was subject to VAT and the other transaction, which covered all financing and insurance elements, was exempt from VAT. The ECJ left it to the national court to determine whether or not this VAT avoidance scheme was abusive but gave it so many directions that the conclusion of the national court should be obvious: the scheme was abusive.

In this context, the ECJ reiterated that, under certain circumstances, several formally distinct services, which could be supplied separately, must be considered to constitute a single transaction when they are not independent, for example where, on the basis of a purely objective analysis, it is found that one or more elements are to be regarded as constituting the principal service, whilst one or more elements are to be regarded, by contrast, as ‘ancillary’ services which share the tax treatment of the principal service. It can also be held that there is a single supply where two or more elements or acts supplied by a taxable person to his customer are so closely linked that they form, objectively, a single, indivisible economic supply, which it would be artificial to split, regardless of the contractual structure of the transaction.

### 4. Cross-Border VAT Avoidance

Cross-border schemes aimed at escaping the national legislation of specific Member States by moving to another Member State have a special dimension because they also involve fundamental freedoms guaranteed by primary EU law, such as the freedom of establishment and the freedom to provide services. Nonetheless, the ECJ was initially prepared to go far in assisting Member States to enforce their national rules. For example, in *Van Binsbergen*, the ECJ declared in 1974 that Member States may prohibit persons from acting as representatives of their clients before a national court on the ground that the representatives are not established there; in *Daily Mail*, the ECJ found in 1988 that companies incorporated under the legislation of a Member State and having their registered office there do not have the right to transfer their central management and control to another Member State for the purpose of avoiding capital gains tax, while retaining their status as companies incorporated under the legislation of the first Member State; and, in *TV 10* and *Veronica*, the ECJ concluded in 1993/94 that Member States do not have to provide access to their non-commercial TV broadcasting systems to entities that broadcast commercial programmes from another Member State where those commercial broadcasts are wholly or principally directed towards the territory of the first Member State. Despite EU law, broadcasting entities should not be enabled to circumvent national legislation designed to preserve a pluralistic and non-commercial broadcasting network by moving their activities to another Member State.

16. In its Opinion of 26 October 2010, Advocate General Mazák noted that the rent payable on the goods was calculated so as to pay back 100% of the cost to Weald Leasing in respect of the payment related to the specific goods in question. It can reasonably be assumed that, at the end of the economic life span of the goods, the lease contracts were terminated.
17. Under EU law, the objective open-market value of the transaction can only be applied if either the supplier or customer is not entitled to full deduction of input tax. That condition was not fulfilled in the relationship between Weald Leasing and Suas.
19. The ECJ described the transactions and circumstances as follows:
   - IFIM and Italservice were part of the same commercial group;
   - the service supplied by IFIM was subject to a division, the financing element was entrusted to Italservice;
   - the service of IFIM was therefore reduced to the rental of a vehicle;
   - the lease payments were only slightly higher than the purchase price of the vehicle;
   - the rental fee, considered in isolation, therefore seemed to be economically unprofitable; and
   - IFIM received the consideration of the leasing transaction only through the cumulative lease payments and the amounts transferred from Italservice.

The national court had to assess whether the principal aim of the contractual approach was the achievement of a tax advantage. In that framework, the ECJ noted that the fact that the payment related to the use of the specific service appeared to be contrary to the objective to tax the total consideration for the leasing of vehicles, and suggested to the national court to take account of the purely artificial nature of the transactions and the links of a legal, economic and/or personal nature between the two service providers involved, those aspects being such as to demonstrate that the accrual of a tax advantage constituted the principal aim pursued, notwithstanding the possible existence, in addition, of economic objectives arising from, for example, marketing, organization or guarantee considerations.
21. ECJ judgment of 5 October 1994 in *TV10 SA v. Commissariaat voor de Media*, Case C-23/93, [1994] ECR 4795, in which the ECJ observed that the freedom to provide services does not preclude a Member State from treating as a “domestic broadcaster” a broadcasting body constituted under the law of another Member State and established in that state, but whose activities are wholly or principally directed towards the territory of the first Member State, if that broadcasting body was established there in order to enable it to avoid the rules which would be applicable to it if it were established in the first state.
23. At the time the ECJ delivered its judgments in *Veronica* and *TV 10*, the Council had already adopted Directive 89/552/EEC of 3 October 1989 on the coordination of certain provisions laid down by Law, Regulation or Administrative Action in Member States concerning the pursuit of television broadcasting activities, OJ L 298 of 17 October 1989, which laid down minimum rules needed to guarantee freedom of transmission in broadcasting in the European Union. Member States had to comply with the provisions of Directive 89/551 with effect from 3 October 1991. The ECJ’s judgment in *TV 10* concerned an appeal of that broadcasting organisation against a decision of the media authorities of 28 September 1989.

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However, there was a turning point in the ECJ’s protective position in 1999, when the ECJ decided that Denmark could not prevent Centros from incorporating in the United Kingdom, which would enable it to avoid the Danish minimum-capital rules, although it exclusively carried out its economic activities in Denmark, through a “branch” located there. The broader freedom for businesses to structure their activities as they pleased was, however, not unlimited. In 2006, the ECJ found that Emsland-Stärke had abused EU law by bringing potato starch outside the territory of the European Union for the purposes of making use of the fact that the restitution of agricultural levies on the exportation of potato starch was higher than the importation of that product. The ECJ found that, in this case, there was no abusive practice but did not clearly indicate the grounds on which the finding was undoubtedly true: the lessor (RBSD) and lessee (Vinci) were definitely legally independent.

In its judgment in Emsland-Stärke, the ECJ formulated the doctrine of abuse of EU law as follows: a finding of an abuse requires:

- firstly, a combination of objective circumstances in which, despite formal observance of the conditions laid down by EU rules, the purpose of those rules has not been achieved; and
- secondly, a subjective element consisting of the intention to obtain an advantage from the EU rules by artificially creating the conditions laid down for obtaining it.

On the basis of the ECJ’s judgments in Emsland-Stärke, Halifax, University of Huddersfield and Part Service, all ingredients for abuse of law seemed to be present in the tax avoidance scheme of Royal Bank of Scotland (RBS). In essence, the scheme concerned the finance leasing of motor vehicles between a lessor in Germany (RBSD) and a lessee (Vinci) in the United Kingdom under the circumstance that a UK bank (Lombard) had selected a German subsidiary as lessor and had also determined the duration of the leasing arrangements with a view to obtaining the tax advantage of no VAT being chargeable on the leasing transactions. The finance lease transaction was not subject to VAT because, under UK VAT law, finance lease was considered to be a service that was subject to VAT at the place where the service provider was established (in Germany), whereas, under German VAT law, the same transaction was treated as a supply of goods that was subject to VAT at the place where the goods were located at the time the supply was made (in the United Kingdom). The ECJ found that, in this case, there was no abusive practice but did not clearly indicate the grounds on which it based its view.

In this context, the ECJ observed that:

- The various transactions concerned took place between two parties which were legally unconnected.
- That finding was undoubtedly true: the lessor (RBSD) and lessee (Vinci) were definitely legally independent. However, the same was true for the entities involved in the abusive schemes of Halifax and University of Huddersfield. Actually, those schemes required transactions between legally independent parties. The scheme of RBS was different in the sense that the lessee, Lombard UK, and a lessor in Germany as the lessor in a transaction with its UK bank selected a German bank as lessor and determined the duration of the leasing arrangements. Such a transfer of business does not occur unless the two banks are connected.

It should also be noted that the facts of the case were more complex, in the sense that the lessee (Vinci) first supplied its own vehicles to RBSD and then leased them back. The question of whether the sale-and-lease-back transaction is a “normal economic transaction” should be answered in the light of the fact that VAT on passenger cars that are not exclusively used for business purposes is non-deductible in the United Kingdom. It seems unlikely that the sale-and-lease-back transaction between Vinci and a lessor in the United Kingdom would have been economically rational since the UK VAT on the lease-back would not have been deductible.

As the national court has observed, the characteristics of the transactions and the nature of the relations between the companies that carried out those transactions contained nothing to suggest an artificial arrangement that did not reflect economic reality and the sole aim of which was to obtain a tax advantage. However, the case file also shows that it was undisputed that the sole aim of channelling the leasing transactions through a lessor in Germany was to obtain a tax advantage of no VAT being chargeable on the leasing transactions. On the supply side, the entire scheme involved three entities that were all connected, i.e. formed part of the RBS Group: Lombard UK that referred Vinci to RBSD, RBSD (first lessor) and Lombard Germany which, after a year and a half, took over the agreements from RBSD. It is unlikely that a UK bank would have selected a bank in Germany as the lessor in a transaction with its UK customer if the two banks were really independent (at arm’s length).

Besides, if it is true that the national court had observed that the characteristics of the transactions and the nature of the relations between the companies that carried out those transactions contained nothing to suggest an artificial arrangement... the sole aim of which was to obtain a tax advantage, it is unclear why the national court referred the matter to the ECJ as regards possible abuse of law.

Anyway, the ECJ reiterated that, where it is possible for a taxable person to choose from a number of transactions, he may choose to structure his business in such a way as to limit his tax liability, and concluded on those grounds that the RBS VAT avoidance scheme did not constitute abuse of law.

It seems inevitable that the conclusion must be that, where Member States interpret the common VAT system differently to the effect that a specific transaction remains untaxed because the two Member States involved take the view that the transaction is subject to VAT in the other Member State, businesses may make use of the gap in the VAT system that the Member States have created themselves. It is of course unfortunate that the ECJ has not yet had the opportunity to close the gap by declaring that finance lease transactions must be treated as supplies of either goods or services for VAT purposes. The urgency of such a decision has, however, been reduced because, from 1 January 2010, B2B leasing transactions are deemed to be supplied at the place where the customer is established, which has the effect that, in the scenario of RBS, the finance lease would be subject to UK VAT, regardless of whether it is a supply of goods or of services.

5. National Provisions Prohibiting Abuse of Law

Although it seems logical that the finding that a specific VAT avoidance scheme constitutes abuse of EU law is not dependent on national rules prohibiting abuse of law, that conclusion is probably incorrect.

In Kofoed, the ECJ was confronted with the question of whether the tax authorities of a Member State can claim that a specific provision of EU law has been abused, if the national legislation of that Member State does not contain a provision prohibiting abuse of that EU provision, although EU law expressly authorizes Member States to adopt such anti-abuse measures. In that respect, the ECJ observed that each of the Member States to which a Directive is addressed is obliged to adopt, within the framework of its national legal system, all the measures necessary to ensure that the Directive is fully effective, in accordance with the objective that it pursues. Moreover, the principle of legal certainty precludes Directives from being able, by themselves, to create obligations for individuals. Directives cannot, therefore, be relied upon per se by the Member State, as against individuals.

However, the ECJ also observed, on the one hand, that Member States may choose the form and methods for implementing Directives which best ensure the result to be achieved by those Directives. Accordingly, provided that the legal situation arising from the national transposition measures is sufficiently precise and clear and that the persons concerned are put in a position of knowing the full extent of their rights and obligations, transposition of a Directive into national law does not necessarily require legislative action in each Member State. Likewise, the transposition of a Directive may, depending on its content, be achieved through a general legal context, so that a formal and express re-enactment of the provisions of the Directive in specific national provisions is not necessary.

On the other hand, the ECJ noted that all authorities of a Member State, in applying national law, are required to interpret it as far as possible in the light of the wording and purpose of the EU Directives in order to achieve the result pursued by those Directives. Moreover, although it is true that the requirement of a Directive-compliant interpretation cannot reach the point where a Directive, by itself and without national implementing legislation, may create obligations for individuals or determine or aggravate the liability in criminal law of persons who act in contravention of its provisions, a Member State may nevertheless, in principle, impose a Directive-compliant interpretation of national law on individuals.

The ECJ’s line of reasoning is not entirely clear but it seems likely that the ECJ takes the position that Member States can rely on the doctrine of abuse of EU law only if their national legislation contains at least a general provision prohibiting abuse of law.

The VAT Directive empowers Member States to adopt specific measures in the framework of various concessional provisions which are aimed at preventing abuse (“tax evasion or avoidance”) through the use of those provisions. Member States may adopt such anti-abuse measures in the framework of:

- VAT grouping;  
- application of the no-supply rule to the transfer of a business as a going concern;  
- application of the open-market value to transactions between connected parties where one of the parties is not entitled to full deduction of input tax.

28. The purpose of Directive 90/434 is to ensure that restructuring operations of companies of different Member States, such as mergers, divisions, transfers of assets and exchanges of shares, are not hampered by restrictions, disadvantages or distortions arising in particular from the tax provisions of the Member States. To that end, Directive 90/434 establishes a scheme under which those operations are not themselves taxable. Any capital gains arising from those operations may, in principle, be taxed, but only at the time at which they actually take place.
29. See Art. 11(1)(a) of Directive 90/434 provides that a Member State may refuse to apply or withdraw the benefit of all or any part of the provisions of... the Directive where it appears that the exchange of shares has tax evasion or tax avoidance as its principal objective or as one of its principal objectives.
30. The Member State in question had not transposed the latter provision into national law.
31. See Art. 11, second paragraph, of the VAT Directive.
application of the exemptions and zero rates laid down by Arts. 132 to 153 of the VAT Directive; and
application of warehousing arrangements other than customs warehousing to goods intended for tax-free shops or to be supplied to non-EU travellers.\textsuperscript{33}

The question arises of whether Member States may apply the doctrine of abuse of law to abusive practices involving those special VAT arrangements, if they have not adopted specific measures to combat abuse of those individual arrangements but have adopted a general anti-abuse provision in their national legislation. On the basis of the ECJ’s judgment in \textit{Kofoed}, that question will probably have to be answered in the affirmative.

However, it should also be noted that the ECJ observed in its judgments in \textit{Kefalas} and \textit{Dionysios Diamantis}\textsuperscript{34} that national judicial institutions may apply national rules on abuse of law to determine whether or not rights derived from EU legislation have been abused, albeit that reliance on national rules may not damage the full functioning and uniform application of EU law and, in particular, it may not alter the scope of EU legislation or endanger the purposes it aims to achieve. The conclusion is therefore that national doctrines of abuse of law cannot be more restrictive on businesses and citizens than the EU doctrine.

6. Other VAT Avoidance Schemes

The ECJ has developed the doctrine of abuse of law on the basis of judgments relating to specific scenarios, which means that the contours of the doctrine become clear step by step. Unfortunately, some of the ECJ’s criteria in this context are rather subjective and somewhat controversial.

It is obvious that, where they have the choice between a number of transactions, taxable persons are not required to choose the transaction which involves paying the highest amount of VAT and that taxable persons are in principle free to structure their activities so as to limit their tax liabilities. It is not disputed that taxable persons are free to apply the VAT exemption for supplies or lettings of immovable property or to opt for taxation of those transactions. Likewise, taxable persons are free to purchase or rent goods for the purposes of their business. However, the latter freedom does not automatically mean that it must be accepted that a taxable person who wishes to purchase goods and actually makes such a purchase (through a connected person) is allowed to spread the burden of the non-deductible input VAT over a large number of years by transforming the purchase into a rental transaction through that connected party.

On the basis of the ECJ’s case law, it is clear that a taxable person’s VAT avoidance scheme is abusive if it has the effect of:

\begin{itemize}
  \item reducing a taxable person’s non-deductible input tax or the total amount of output tax due by involving connected parties in making or receiving specific supplies; or
  \item artificially splitting up services supplied by connected parties that must be considered to constitute a single service for VAT purposes.
\end{itemize}

It is also clear that a VAT avoidance scheme is not abusive where:

\begin{itemize}
  \item it produces only a cash flow advantage. A cash flow advantage in the form of spreading the burden of the tax over a large number of years is apparently not an abusive tax advantage; or
  \item taxable persons creatively make use of different interpretations of the Member States of provisions of the common system of VAT, even if their creativity has the effect that VAT is not payable at all.
\end{itemize}

If the making use of different interpretations by Member States of the uniform VAT system qualifies as non-abusive, the same qualification probably applies if taxable persons make use of the fact that Member States have not transposed specific provisions of the VAT Directive into their national legislation. For example, taxable persons who are not entitled to full deduction of input tax are probably allowed to channel the purchase of services through an umbrella organization\textsuperscript{35} located in a Member State that has not transposed the controversial exemption for the services of cost-sharing associations into its national VAT legislation.

The situation becomes less clear where the members of a cost-sharing association are financial institutions and the Member State where the members of the cost-sharing association are established has lawfully excluded financial institutions from the exemption or has excluded specific services from the exemption, on account of the finding that the exemption distorts competition.\textsuperscript{36} It is likely that the taxable persons’ freedom to structure their activities so as to limit their tax liabilities includes the establishment by the members of a cost-sharing association of the umbrella organization in a Member State where the services in question are not covered by the exemption for the services of cost-sharing associations.

\textsuperscript{32} See Art. 131 of the VAT Directive.
\textsuperscript{33} See Art. 158(2) of the VAT Directive.
\textsuperscript{35} Under Art. 132(1)(f) of the VAT Directive. Member States must exempt the supply of services by independent groups (‘umbrella organizations’) of persons, who are carrying on an activity which is exempt from VAT or in relation to which they are not taxable persons, for the purpose of rendering to their members the services directly necessary for the exercise of that activity, where those groups merely claim from their members exact reimbursement of their share of the joint expenses, provided that such exemption is not likely to cause distortion of competition. It is not clear whether umbrella organizations may also act as purchasing cooperatives.
\textsuperscript{36} If the umbrella organization is established in Member State A and its members in Member States B, C and D, and only Member State A has excluded automation services from the exemption, the members can purchase those services through the umbrella organization free of VAT because, from the perspective of the members, the services are deemed to be supplied at the place where the members are located where the services of umbrella organizations are exempt from VAT and, from the perspective of the umbrella organization’s right to deduct input tax, the services are taxed.
Channelling their purchases of services through a fixed establishment located in a country outside the European Union in which the services are not subject to VAT or a similar tax could more clearly be abusive if this VAT avoidance scheme is applied by taxable persons who are not entitled to full deduction of input tax. However, even if it must be assumed that the services have actually been supplied to the fixed establishment, Member States can easily combat that tax avoidance scheme by applying the effective-use-and-enjoyment criterion. If they have not applied that criterion, Member States should still be able to combat VAT avoidance schemes involving fixed establishments located outside the European Union on the basis of a general legal provision prohibiting abuse of law or on the basis of the view that services supplied to taxable persons by fixed establishments located outside the European Union constitute taxable services for VAT purposes. Also, an agreement between a taxable person who is not entitled to full deduction of input tax and an independent service provider to channel the services through a new entity that will subsequently be included in the VAT group to which the customer also belongs seems to be abusive. However, Member States also have the power to combat tax avoidance schemes involving abuse of the VAT-grouping arrangements.

Finally, “lease funding” should not qualify as abusive. In this context, lease funding refers to an arrangement under which the lessee, who is not entitled to full deduction of VAT, channels the purchase of goods through an independent leasing company, albeit that, in order to keep the lease payments low, the lessee grants a loan to the lessor, which is sufficiently large to cover the purchase price of the leased goods. The loan has the effect that the lessor does not have to finance the purchase and, consequently, the lease payments do not include an interest element. However, unless the lease funding arrangements contain other manipulations, the customer (lessee) in the end pays the full burden of VAT on the total purchase price and he also pays the full purchase price of the goods.

### 7. Conclusions

By introducing the concept of abuse of EU law, the ECJ has made the EU VAT system much fairer, in the sense that it has become less vulnerable to various kinds of artificial tax avoidance schemes set up by taxable persons who are not entitled to full deduction of input tax or non-taxable legal persons. The concept of abuse of law also has the effect of eliminating distortions of competition resulting from artificial schemes aimed at reducing output tax.

The principle of abuse of law is a principle of EU law. However, there is a certain tension between that principle and the EU principle of legal certainty, which precludes Directives from being able to themselves to create obligations for individuals. Consequently, the principle of abuse of law only applies where the national legislation of the Member States contains an anti-abuse provision that is sufficiently precise and clear to ensure that the persons concerned are able to know the full extent of their rights and obligations.

Strangely, the existence of national anti-abuse rules has never actually played a role in the various cases in which the ECJ developed the doctrine of abuse of law in the area of VAT. In the absence of the ECJ’s judgment in Kofoed, the impression could easily have arisen that, just like all other principles of EU law, the principle of abuse of law likewise applies under all circumstances. Broad and unconditional application of the principle of abuse of law is actually more appropriate for an area of EU law that is (fully) harmonized and is also consistent with the ECJ’s unconditional finding that EU law cannot be relied on for abusive or fraudulent ends.

National concepts of abuse of law developed under case law of national courts cannot be broader than the corresponding EU concept and, depending on the national provision prohibiting abuse of law, can generally also not be narrower, which is also appropriate for a harmonized area of EU law. There is also a certain tension between the principle of abuse of EU law and the freedom for businesses to structure their activities so as to limit their tax liabilities (the burden of VAT). At this stage of development of the doctrine of abuse of law, it seems that the scope of the doctrine is limited to artificial schemes involving connected parties which are aimed at reducing the total amounts of non-deductible input VAT or output VAT.

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37. Under Art. 11(1) of Implementing Regulation 282/2011, for the application of Art. 44 of the VAT Directive, a “fixed establishment” is any establishment, other than the place of establishment of a business [...] characterized by a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to receive and use the services supplied to it for its own needs.

38. Under Art. 44 of the VAT Directive, B2B services are generally deemed to be supplied at the place where the customer is established or has a fixed establishment. Art. 59a(b) provides that, in order to prevent double taxation, non-taxation or distortion of competition, Member States may, with regard to services the place of supply of which is governed by Art. 44 [...] consider the place of supply of any or all of those services, if situated outside the European Union, as being situated within their territory if the effective use and enjoyment of the services takes place within their territory.

39. The second paragraph of Art. 11 of the VAT Directive provides that a Member State exercising the option provided for in the first paragraph (VAT-grouping arrangements), may adopt any measures needed to prevent tax evasion or avoidance through the use of this provision.
In his recent article “Technology Can Solve MTIC Fraud – VLN, RTvat, D-VAT certification”, Richard Ainsworth discussed the three main options that claim to be capable of resolving missing-trader VAT fraud, and concluded that real-time VAT collection (RTvat) is the only solution that is actually capable of preventing that type of fraud and limiting several other forms of fraud. In this follow-up article, Chris Williams briefly responds to Richard Ainsworth’s reservations as regards the central auditing function that forms part of RTvat’s proposal for real-time VAT collection. Richard Ainsworth has the final word in this discussion on the merits of real-time VAT collection in general and RTvat in particular.

1. Introduction

In his article “Technology Can Solve MTIC Fraud – VLN, RTvat, D-VAT certification”, 1 Professor Ainsworth is quite correct with his overall conclusions that:

– “the only solution that is actually capable of preventing missing-trader fraud and also limits several other forms of fraud... is RTvat”;
– “RTvat is by far the most promising and practical solution for a robust VAT system”; and
– “… RTvat (as proposed) is an origin-based tax system... however, RTvat could just as easily be destination based”.

As regards his latter conclusion, the RTvat system could indeed be used equally, easily and effectively in a VAT system that is either origin based or destination based, or even a combination of the two, as the flow of funds between customer, supplier and tax authorities is completely seamless and the direction depends only on the rules programmed into the underlying rule base, which is generated from the rates, rules and regulations in force in each Member State and between any two Member States. Provided that those rules can be defined, the RTvat system can apply them.

The following comments relate to four connected issues:

1. Protection of data used for real-time fraud analysis

As regards Richard Ainsworth’s concerns about the security of the Tax Authority Settlement System, it should be noted that the TASS is based on the technology used in the credit card industry and that the PCI-DSS (Payment Card Industry – Data Security Standard) Council has set out extremely strict rules on how any data relating to transactions must be stored and transmitted. The RTvat system has been designed from the start to comply with these terms in the strictest manner, also for data that gives background information on companies within the system, as well as data relating to actual transactions.

The methods of applying fraud analysis are, for obvious reasons, extremely confidential and Richard Ainsworth is correct in stating that a key factor is the comparison of overall financial performance of the two parties involved in a specific transaction.

The comparison data is based on the specific information and track record of the two companies (or one company and the final consumer) and a separate structure which looks at similar companies by business type, area and size. It is important to recognize that the data used for this comparison is not specific to the competitive companies, but is solely based on industry sector averages, so data protection rules are maintained.

It should also be noted that the PCI-DSS Council takes its responsibilities very seriously and has recently withdrawn any new approvals of mobile-telephone-based payment (MPBP) products. Much effort is being invested in resolving the safety issues in this area because MPBP will certainly have a major role to play in all parts of the world in the near future, and it is essential that the security structure is in place to manage MPBP products too.

1.2. Encouraging the move from cash to electronic payments

Real-time VAT collection is based on electronic payments. Although electronic payments are developing very rapidly, there will always be a group of people who want to use cash: they may distrust the government, or be against any form of electronic data sharing. It is important that their voice be heard and that some facility is preserved for...
them to continue to use cash. However, the world is rapidly changing: for example, it is nowadays not easy to buy an airline ticket for cash at the airport; some retail outlets are considering accepting electronic payments only, at the London 2012 Olympics all payments must to be made through Visa, etc.

There is another – far larger – group that is reluctant to give up the anonymity of cash: tax evaders and other criminals who wish to hide their illegal transactions. In order to successfully reduce VAT (and other) fraud to more acceptable levels, this group needs to be addressed.

Ensuring a movement from cash to electronic payments can be achieved by a “carrot-and-stick” approach.

As Professor Ainsworth mentioned in his article, there are a number of jurisdictions, mostly in Latin America, Asia and Africa, where incentives exist for electronic payment for goods and services. Those carrots may even take the form of a reduction of the VAT due on transactions that are paid for by electronic means, or a refund of the payment-processing fee.

Carrots can also take the form of rewards offered by the tax authorities to individuals who inform them – confidentially – that they have reason to believe that specific businesses (their suppliers) that accept cash payments may be committing tax fraud. Customers may also be rewarded if they register the details of receipts online and if it appears that the supplier has underpaid the tax on that (and other) transactions.

The “stick approach” may take the form of:

- imposing more burdensome administrative obligations on suppliers who accept cash as payment for their transactions (requiring them to issue numbered receipts, including the amount of VAT payable, on each sale, and to keep a duplicate of the receipts);
- requiring suppliers who accept cash payments to deposit all VAT collected on a daily basis in a bank account;
- excluding suppliers that primarily sell for cash from accelerated refunds; and
- holding customers jointly and severally liable for payment of the tax that their supplier failed to remit on transactions for which the customer paid in cash (to that end, final consumers would also be required to keep their receipts for a defined period after the transaction – say, up to five years).

The measures may not be very practical but they convey a clear message to businesses and final consumers: paying in cash for goods or services may have repercussions for your own financial position due to the fact that your behaviour creates possibilities for the supplier to commit fraud.

1.3. Overall reduction of tax fraud

VAT fraud is not an isolated phenomenon. If a small merchant decides to cheat on the VAT by keeping 50% of his cash sales outside his business records, it is unlikely that he will pay income tax and social security contributions on his full income, which means that a loss of VAT can easily give rise to a total tax loss that is twice as large.

The OECD assessment of the European Union’s average “take” of just 55% of potential VAT – versus 75% in Switzerland and 100% in New Zealand – is an indication of not only the fraud evasion rate but also the avoidance rate in the European Union. Those factors contribute, to a large extent, to the overall view of the public that the tax system is unfair. That perception will lead to declining tax morality.

The use of data from one tax source to assist in collecting other taxes and the application of a central clearing and calculation facility for the withholding by employers of tax (PAYE) on their employees’ wages are further areas to consider. Employers would submit the gross amount for all employees to the central server. All allowances would be calculated at the central server, before distributing the funds electronically to bank accounts, stored value cards or mobile-telephone-based accounts.

The clear picture should be that real-time collection of VAT through a central clearing system brings not only a massive reduction in the unacceptable fraud level, but also produces linked benefits on top of that.

1.4. Introduction of real-time VAT collection in the European Union

If real-time collection of VAT, in the manner proposed by RTvat, were to be introduced Union-wide, businesses would benefit from increased transparency of their VAT position and they would no longer run the risk of being assessed for VAT that others in the chain failed to remit. Automation of the processes of remittance and refunds of all VAT (other than for cash) is a clear benefit. Some groups representing large enterprises claim that making any change to the bookkeeping, invoicing and ERP systems of large enterprises is difficult, expensive and time consuming – on the basis of the same arguments, banks have successfully delayed the deployment of SEPA for more than ten years. However, this reaction cannot be justified on technological or financial arguments when the costs and benefits are objectively considered.

The advantages of real-time collection of VAT for the tax authorities not only consist of preventing huge tax losses. The RTvat system is based on a Public/Private Partnership. The private-sector participants would fund the initial investment and operational cost of the technical infrastructure, and would recover the cost by means of a transaction fee on each electronic payment.

The world of payments has changed dramatically since the VAT rules were originally formulated in 1967. The sheer power of data management capability that has been

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developed by companies such as Google, PayPal, Apple and Facebook has brought even more sharply into focus worldwide payments by electronic means, with the enormous expansion of mobile-telephone payments.

Technology Can Solve MTIC Fraud – 3 and Final

What can be built by humans, can also be destroyed by (other) humans. However secure an electronic network may be, and however strictly the protocols for the use of the network may be applied, any electronic system, including that of banks or credit card companies, is bound to be attacked by hackers sooner or later. Although businesses in specific EU Member States are already required to file their periodic VAT returns and recapitulative statements in electronic format, and although Luxembourg seems already to apply a system (Fichier d’audit informatisé) for online auditing of businesses by the tax authorities, operation of a Union-wide electronic network that gives access to the business records of dozens of millions of large, medium-sized and small businesses is a different matter. The mere size of the project is worrying on account of the related privacy aspects.

However, a central auditing function is not an essential element to completely eliminate missing-trader fraud of the type that has been spreading throughout the European Union in the last decade. The real-time VAT collection mechanism alone has the effect that fraudsters will no longer be able to get their hands on and embezzle the VAT that their customers have paid. This is RTvat’s key attribute – it focuses on the money.

Preventing that type of missing-trader fraud was the main topic of my article, although I also noted that the introduction of real-time VAT collection would make it much more difficult for retailers to commit suppression fraud, i.e. pretend that their turnover is considerably lower than it actually was. Most national and international B2B transactions are already paid for through banks and also final consumers increasingly pay retailers by means of plastic money, which means that the VAT collection system can simply hook on to an existing payment infrastructure. If tax authorities cannot effectively monitor flows of goods and services, they should focus on the one element of individual transactions that they can monitor, i.e. payments made through trusted third parties.

Chris Williams is correct in saying that there will always be final consumers and businesses (including fraudsters) that prefer to make their payments with “real money”, and that VAT systems should not be designed to accommodate fraudulent businesses who use cash payments to hide their fraudulent transactions. Introduction of real-time VAT collection, even without a central auditing function, would also considerably limit the possibilities for businesses to commit other types of fraud, including suppression fraud. Measures to combat suppression fraud already exist in other jurisdictions; for example, fraud in B2B relationships can be limited by introducing the rule that businesses can only deduct VAT (above a specific – low – threshold) if they have made the related payment by means of bank transfer. That condition can seamlessly be combined with real-time VAT collection.

Suppression fraud in B2C relationships can be limited by requiring retailers to record their cash transactions by means of certified electronic cash registers (ECRs). In order to prevent retailers from adding sales suppression devices to their ECRs and point-of-sale (POS) systems to “hide” cash sales from the tax authorities, the latter may require that retailers add an encrypted transaction trail to each receipt (to facilitate audit), and penalize any retailer who carries out taxable transactions without issuing this kind of receipt. The necessary technology comes as a bolt-on device that can be added to each ECR or POS system for a price of approximately USD 350.

A basic real-time VAT collection mechanism only requires that the bank knows the amount of VAT that the supplier has charged to his customer. The bank and, at that stage, also the tax authorities do not have to possess any other details mentioned on the invoice. In this respect, it is not entirely clear whether, in Chris Williams’ view, the VAT component is split off from the customer’s payment on the basis of the VAT mentioned on the supplier’s invoice or whether it is calculated by the central auditing system. In my view, VAT liabilities should be based on what the supplier charged to the customer on the invoice. Even if the VAT is incorrect, not much harm is done in most B2B relationships because the customer receives the same (incorrect) amount from the tax authorities. Charging an incorrect amount of VAT in most B2B relationships hardly qualifies as fraud. The B2C situation is a different matter all together.

* Adjunct Professor, Boston University School of Law.
It is an illusion to believe that businesses can be fully audited by a central auditing system, which is, however, not necessarily one of the key features of a real-time collection mechanism. For example, where a tax adviser gives advice to an EU business customer who is not entitled to deduct input VAT, the system cannot discover that the tax adviser saves his customer non-deductible VAT by addressing the related invoice to the customer’s fixed establishment located outside the European Union.

Finally, Chris Williams is absolutely correct in saying that discovery of VAT suppression fraud at the retail stage probably also affects the collection of, for example, income tax. It has been standard practice for more than 40 years, at least in specific Member States, that when a business has been found to have accounted for VAT on only part of its transactions, the resulting VAT assessment is accompanied by an additional assessment for income tax. Introduction of a real-time collection mechanism, accompanied by a central audit function, may undoubtedly have a beneficial effect on the collection of other taxes as well. However, other taxes were outside the scope of my article.
A New Defence for Victims of EU Missing-Trader Fraud?

The downside of the system of fractionated remittance of VAT is that it makes the VAT system vulnerable to missing-trader fraud. Despite all anti-fraud measures that have already been taken in the European Union, the phenomenon of missing traders seems not to be under control. However, the accumulated anti-fraud measures and practices of the tax authorities have resulted in unacceptably high compliance burdens and uncertainty for the business community. In this article, the authors explain that newly available legal and technological means could make the burdens of the VAT system on EU businesses proportionate again. If Member States would make full use of its potential, Eurofisc could play a crucial role in the process of restoring the proportionality of the EU VAT system. If necessary, the ECJ could push Member States into the right direction.

1. Introduction

The VAT system was introduced in the European Union in 1968 as a supplement to the abolition of customs duties on trade between Member States and the prohibition of State aid. VAT was aimed at eliminating artificial price distortions which prevented an optimal use of scarce production resources in the single market.

The EU VAT system turned out to be so efficient in raising tax revenues that, with some amendments, it has been adopted by almost all the countries in the world. The comparative success of the VAT system is based on a combination of factors. Firstly, the use of detailed invoices as the basis for reporting VAT liabilities provides the tax authorities with useful information (“audit trail”). Secondly, the customers’ right to deduct VAT on their purchases encourages them to fully report subsequent supplies and to carefully retain the purchase invoices (the “self-policing” feature of VAT). Finally, the VAT mechanism leads to fractionated remittance of VAT to the tax authorities, which spreads the collection risk as compared to a retail sales tax. In practice, a large part of the total VAT revenues is normally remitted to the tax authorities by a very small group of large and reliable businesses.

The downside of the system of fractionated remittance is that it makes the VAT system vulnerable to missing-trader fraud. This type of fraud occurs where a fraudulent trader supplies goods or tradable services to other businesses, collects the VAT due on the supply from his customers and disappears before remitting the VAT to the tax authorities; the fraud becomes financially attractive if the fraudulent trader did not have to pay VAT to his suppliers on his inputs and can easily avoid reporting the VAT that he is legally required to account for himself on his purchases, i.e. on the “importation” of goods and tradable services from another Member State (giving rise to MTIC fraud) or from a country outside the European Union (giving rise to MTEC fraud). Although the fraud concerns domestic transactions, the preparatory stage is a cross-border transaction.

This type of missing-trader fraud should be distinguished from “export fraud”, i.e. a situation in which suppliers pretend that they have “exported” goods or services and, therefore, are not liable to remit VAT on those supplies, whereas, in reality, they have supplied the goods or services to domestic customers. The two types of fraud have in common that the “suppliers” or “exporters” are able to disappear (go missing) after they have received from their customers the VAT on – real or fake – supplies and before the tax authorities notice that the traders have not remitted the VAT due. This article mainly focuses on missing-trader fraud of the first type.

By adopting Directive 91/6805 in 1991, the EU Council deliberately took the risk of increasing the opportunities for missing-trader fraud. The combination of zero rating intra-Community supplies of goods and abolishing customs controls at internal borders made it more difficult for national tax authorities to detect intra-Community transactions that can lead to missing-trader fraud at an early stage. For the purpose of reducing the risk of missing-trader fraud, Member States have subsequently adopted...
opted a series of anti-fraud measures. As a result of those measures, businesses today face high compliance costs and they are confronted with an unacceptably high level of legal uncertainty.

Despite all anti-fraud measures, the phenomenon of missing traders seems not to be under control. A report recently submitted by PricewaterhouseCoopers to the European Commission and a Council document accompanying the adoption of Directive 2009/699 suggest that further anti-fraud measures are under consideration. The administrative obligations currently applicable focus on MTIC fraud and do not affect MTEC fraud.

2. Combating VAT Fraud

The starting point of this article was a discussion between the authors on the introduction of a single EU VAT return as a means of combating missing-trader fraud. However, we quickly abandoned that idea because it is clear that Member States do not wish to lose, or even share, control of the VAT collection process. Creating a central database at European level or granting the tax authorities of other Member States access to the national database with compliance data seems a bridge too far for some Member States.

This article examines the damage that missing-trader fraud and the anti-fraud measures have caused so far, and whether or not the accumulation of anti-fraud measures, especially the “knowledge test” (see 3.1), is still in line with the proportionality principle. If specific measures or practices of the tax authorities should be found to have become disproportionate, the Court of Justice of the European Union (ECJ) may be able to prevent further damage to the economy.

3. Damage Caused by Missing-Trader Fraud

By not remitting to the authorities the VAT due on their transactions or by falsely presenting their transactions as zero-rated exports, missing traders can offer substantial price reductions to their customers, which has an artificial and adverse effect on prices in the European Union, and affects competition, localization of specific activities and investment decisions of businesses.

In addition, the answer of the ECJ to missing-trader fraud and the anti-fraud measures have caused so far, and whether or not the accumulation of anti-fraud measures, especially the “knowledge test” (see 3.), is still in line with the proportionality principle. If specific measures or practices of the tax authorities should be found to have become disproportionate, the Court of Justice of the European Union (ECJ) may be able to prevent further damage to the economy.


8. ECJ judgment of 12 January 2006 in Optigen Ltd, Fulcrum Electronics Ltd and Bond House Systems Ltd v. Commissioners of Customs & Excise, joined Cases C-354/03, C-355/03 and C-484/03, [2006] ECR I-483
10. It is remarkable that the ECJ did not pay any attention to what the tax authorities knew or could have known at the time the fraudulent transaction took place and what they had done or could have done to prevent the fraud or to prevent the businesses involved in the proceedings from paying VAT to their fraudulent suppliers.
11. The High Court referred the questions in Optigen (note 8) to the ECJ on 28 July 2003 and the ECJ delivered its judgment almost 30 months later.
13. Reckon Report, Study to quantify and analyse the VAT gap in the EU 25 Member States, 21 September 2009. It should be noted that the VAT gap also includes VAT losses not due to fraud.
and judicial procedures due to unclear VAT legislation (wasted value) and costs of incorrect decisions of the tax authorities (having the effect that innocent, bona fide companies go bankrupt on account of recovery by the authorities of VAT lost because of fraud committed by others). Adding up the estimates of all those elements will result in a much higher figure than Reckon’s VAT gap.

4. Missing-Trader Fraud in Perspective

Missing-trader fraud is as old as VAT itself. VAT was introduced in France in 1954 and, in the early days of VAT, criminal organizations collected scrap iron for free or from private individuals, and sold the iron to steel companies with VAT, which the scrap traders did not remit. The related invoices were generally issued by tramps, who were found dead shortly after the tax authorities traced the fraud.15 The authorities responded to the fraud by treating the sale of scrap iron as being outside the scope of VAT, which made it impossible for the steel companies to deduct VAT which the scrap traders had not remitted. Similarly, French producers of television sets forged export documents in order to deduct input VAT on their production cost without having to remit output tax. However, the television sets were sold in France.16 Also the immovable property sector has been vulnerable to fraud from the outset: many small businesses engaged in immovable property transactions went bankrupt17 before remitting the VAT to the authorities. The solution was the application of the reverse charge mechanism.18

From 1 January 1993, missing-trader fraud in the European Union exploded as a consequence of the abolition of customs control of intra-Community trade in goods. In its White Paper of 14 June 1985,19 the Commission stressed the importance of removing the internal fiscal frontiers as part of the process of completing the internal market. The economic and political objectives of the Single European Act20 were seen as being incompatible with customs procedures at the internal borders of the European Union. As part of the creation of the European single market, the Cockfield proposal of 198721 suggested that intra-Community supplies of goods should be subject to VAT at the rate applicable in the supplier’s Member State (i.e. under the “origin principle”). Customers would be entitled to deduct this foreign VAT through their periodic VAT returns.22 In retrospect, it is curious that a consumption tax was to be levied in the Member State of origin. The origin principle was already laid down by the First VAT Directive of 1967.23

It is generally said that the Cockfield proposal encountered severe and never-ending irrational “political opposition” of Member States that did not trust each other or the European Commission. This impression is based on statements made by prominent civil servants, who publicly accused the European Commission of having the sole intention of limiting the control of Member States on the collection of taxes and, therefore, of limiting the political autonomy of Member States.24 However, unpublished documents tell a different story. The Council’s objections to the origin principle were far from “irrational” and were based on the intrinsic weaknesses of the Commission’s proposal. During a meeting held on 21 and 22 January 1988, the Council Working Group on financial questions drew up a detailed list of technical objections.25 The validity of those objections had been confirmed at that time by national parliaments,26 businesses27 and scientific studies.28 The criticism not only concerned the weakness of the clearing house mechanism, but also concerned the circumstance that the proposal did not take into account important elements, such as the importation of goods from third countries, distance sales, purchases by SMEs, banks and insurance companies and public authorities, administrative cooperation between Member States, and supplies of services; it also ignored the fact that a European currency did not exist. Adopting the Cockfield proposal would have entailed the risk of huge practical difficulties for businesses.

References

15. Maurice Lauré, Science Fiscale, PUF, 1993, pp. 239 and 240.
17. Not all businesses went bankrupt with the intention of not paying their VAT liabilities.
20. Art. 8a of the Single European Act (SEA), 01 of 29 June 1987, provided that “The Community shall adopt measures with the aim of progressively establishing the internal market over a period expiring on 31 December 1992 [...]. The internal market shall comprise an area without internal frontiers in which the free market of goods, services and capital is ensured in accordance with the provisions of this Treaty.” The SEA was the first major revision of the 1957 Treaty of Rome. The Act set the objective of establishing a single market by 31 December 1992, and adopting codified European political cooperation, which was the forerunner of the European Union’s common foreign and security policy. The SEA was signed in Luxembourg on 17 February 1986, and in The Hague on 28 February 1986 and came into effect on 1 July 1987.
22. COM(87) 322 (see note 21).
23. Adoption of the origin principle may be attributed to the controversy between France and Germany in 1953 about the qualification of the French “taxe à la production” as an indirect tax (and therefore French businesses were able to obtain the refund of this tax at the time they exported steel) under the FCS Treaty. On 10 April 1954, the French parliament transformed the production tax into the “Taxe sur la valeur ajoutée”; see Christian Amand, “Are VAT Exemptions Compatible with Primary EU Law?”, International VAT Monitor 6 (2010), p. 409.
Consequently, the VAT regime that accompanied the abolition of the internal fiscal frontiers maintained the zero rating of “exports” (intra-Community supplies of goods) and taxation of “imports” (intra-Community acquisitions of goods), and replaced border controls by documentary evidence to be provided by suppliers as regards physical delivery of goods, and by monitoring intra-Community movements of goods on the basis of quarterly recapitulative statements (EU sales lists). Just like under the “Benelux 50 system”, which applied to cross-border supplies of goods between Belgium, the Netherlands and Luxembourg until 1993 and which was based on “postponed accounting”, the customer had to account for VAT on the intra-Community acquisition of goods through his periodic VAT return and was entitled to deduct the VAT through the same return. However, the Benelux 50 system had proved to be sensitive to fraud and the EU Council was aware of that risk. In a document of 6 April 1988, the majority of members of the Council ad hoc group on the abolition of fiscal frontiers concluded that a system based on the “Benelux model” could not be recommended because of the administrative burdens which it would put on both revenue authorities and traders, the difficulty of carrying out checks, and the vulnerability of the system to fraud. Also, in a study published in December 1992, Maurice Lauré warned that “the abolition of fiscal frontiers in a multinational Europe will create fraud of a criminal nature”.

The system for taxation of intra-Community transactions breaks the “VAT chain” at a particularly vulnerable spot: the interface of the jurisdictions of the tax authorities of two Member States. The only incentive for customers to declare the acquisition of goods is the fact that they know that the tax authorities will eventually be informed about the purchase. However, the flow of information was – and still is – not very efficient because of:

- delays caused by the fact that businesses file their VAT returns and sales lists on a monthly, bimonthly, or quarterly basis;
- delays in processing the information, which was initially provided on printed forms instead of in electronic format;
- the fact that, for various reasons, the tax authorities never audit many businesses;
- the fact that the list of valid VAT identification numbers included in the VAT Information Exchange System (VIES) may not be up to date; and
- reluctance of tax inspectors to ask the tax authorities of other Member States for assistance and information due to the long, hierarchical and bureaucratic request procedure and the risk that the requesting authorities may never receive a response.

Abolition in 1993 of the internal fiscal frontiers and of customs control of intra-Community supplies of goods was a political reality, and the VAT regime that was introduced at that time was probably the best solution. However, it is questionable whether the arguments for rejecting the Commission’s proposal are still as strong as they were 20 years ago.

5. Response to Missing-Trader Fraud

Much has been written on how EU Member States have responded to missing-trader fraud and how the logic, effectiveness and consequences for businesses of the anti-fraud measures must be assessed. The anti-fraud measures can be classified in four categories:

- measures aimed at protecting tax revenues (5.1.);
- administrative obligations on businesses (5.2.);
- measures aimed at limiting the possibility for businesses to acquire goods and services without having to pay VAT (5.3.); and
- measures aimed at reducing the response time of the tax authorities to fraud (5.4.).

5.1. Protection of tax revenues

The measures aimed at protecting tax revenues have proved to be effective. They are not aimed at catching fraudsters but at preventing revenue losses by applying the reverse charge mechanism (or the zero rate) to domestic B2B supplies of fraud-sensitive goods (such as scrap materials, mobile telephones) and tradable services (such as transfers of CO₂ certificates and unallocated precious metals in the United Kingdom). The effect of the measures is limited to preventing fraudsters from receiving any VAT from their customers for the purpose of embezzling it.

Introduction of the reverse charge mechanism in, for example, the market for CO₂ certificates was a success, in the sense that the advantages outweighed the disadvantages. However, taking this solution one step further, i.e.


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introduction of a generalized reverse charge mechanism applicable to all domestic B2B transactions, will shift the risk of fraud to the retail stage, which will probably have a significant negative impact on VAT revenues. Introduction of a generalized reverse charge mechanism depends on the fulfillment of specific conditions and has advantages and disadvantages.

In a recent report, PricewaterhouseCoopers suggested, inter alia, the split-payment model as a solution to missing-trader fraud. Proponents of that model point out that the system of “VAT accounts” works well in Azerbaijan but it should also be noted that, at the time it acceded to the European Union, Bulgaria abolished its system of VAT accounts on the ground that it had given rise to large-scale fraud. Anyway, in view of its adverse effects on the cash flow of businesses, a system of VAT accounts does not seem to be a realistic option for the European Union.

5.2. Administrative obligations on businesses

A second category of anti-fraud measures involves increasing the administrative obligations on businesses, including an increase of the reporting frequency and the level of detail of the reports, in addition to the requirement that the reports must be filed in electronic format. The reporting frequency for EU sales lists has generally been increased from a quarter to a month. However, increasing the reporting obligations on businesses is useless if the tax authorities do not make proper use of the information. Furthermore, national rules applicable in Member States as regards the format of VAT invoices, business records and VAT returns, and national deadlines for issuing invoices and for reporting transactions for VAT purposes go beyond generally accepted accounting standards and disregard the difficulties for multinational businesses. Tax authorities cannot reasonably expect multinational businesses to be compliant with 27 different sets of national VAT rules.

Extension of the obligation on businesses to provide information to the tax authorities could eventually lead to what PricewaterhouseCoopers described as models for a central VAT-monitoring database and a data warehouse. Under the two models, the tax authorities have direct access to the accounting systems of businesses. However, much of the information is highly confidential and it can reasonably be expected that, sooner or later, the databases of the tax authorities will be hacked and that third parties will have gained access to commercial secrets. It is easier for hackers to gain access to a large database than to the database of an individual business.

5.3. Reducing the possibilities of purchasing goods and services without incurring VAT

In its Green Paper, the European Commission proposed to tax intra-Community supplies of goods and services at the VAT rate and under the rules of the Member State where the customer is established, regardless of the actual physical movement of the goods. This solution would restore the principle of fractionated payments in respect of intra-Community transactions and should be examined carefully because, on the one hand, it would substantially simplify the administrative burdens on businesses (VAT registration in other Member States would hardly be necessary) and the monitoring of cross-border movements of goods by the tax authorities. However, on the other hand, it also continues to provide fraudsters with possibilities to commit missing-trader fraud by purchasing goods or tradable services from suppliers established outside the European Union and, subsequently, supplying them to businesses established in the same or in another Member State. Of course, the importation of goods is subject to customs procedures, but customs controls are not effective if the importers must account for import VAT under postponed accounting, which has become possible in an increasing number of Member States.

operating at European level on account of the fact that the reverse charge mechanism does not apply uniformly in all Member States. See Opinion of the Confédération Fiscale Européenne on persons liable for payment of VAT to the tax authorities regarding operations taking place in one Member State, submitted to the European Institutions in February 2011.


41. The argument that apparently convinced the Council was the Finnish experience that showed that, for the same rate of taxation, a VAT system is twice as efficient as a sales tax system; see also European Parliament Working Papers – Options for a definitive VAT Systems – Economic Af-fairs Series E: 5 (Patterson Report), p. 15.

42. The introduction of a generalized reverse charge mechanism must be accompanied by the possibility to quickly and reliably verify VAT identification numbers and has the effect that suppliers must make a distinction between customers who have and those who do not have a valid VAT identification number. It is inevitably accompanied by the obligation on businesses to report individual transactions, in order to mitigate the risk that transactions go missing. It also offers the opportunity for a deal between businesses and tax authorities: application of the reverse charge mechanism against more extensive but simpler monthly reporting of sales and purchases, which would reduce the number of reporting errors. The self-policing feature of the VAT system could be fully restored through a reward/penalty regime: the customer is rewarded for correctly reporting a transaction which has been misreported by the supplier, and vice versa. In order to avoid endless discussions, customers are implicitly encouraged to pay their suppliers by means of bank transfers. The same reward/penalty regime can also be applied to other reporting requirements.

43. See note 6.

44. Under the split-payment model, customers must transfer the VAT element of the total price to their supplier’s blocked bank account. The suppliers can only use the balance of that “VAT account” for remitting VAT to the tax authorities or for paying VAT to their suppliers, who must also have a VAT account.

45. Id.

46. The idea of giving the tax authorities access to the accounting systems of businesses is not really new and has already been recommended by the OECD, see Guidance Note: Guidance for the Standard Audit File – Tax (SAF-T). This guidance note focuses on the creation of a computer file that allows the easy export of a predefined set of accounting data in a commoddy readable format. This file also makes it easier for businesses to submit their electronic records to the auditor in support of their tax returns and for auditors to review businesses’ accounting records. Such a system has already been adopted by some Member States, such as Luxembourg’s Fichier d’audit informatique [http://www.aed.public.lu/actualites/2009/11/FAIA/FAIA-fichier_Audit_informats___AED_vers_1_4.pdf].

47. When a hacker penetrates the database of an individual company, it is relatively easy to establish the parties that might be interested in the information that is stolen because the interested parties are limited to the company’s actual or potential competitors. It would be more difficult to establish the parties that might be interested in the information that is stolen from the tax authorities’ data base.


49. For the purpose of avoiding input tax, fraudsters can no longer purchase goods and services in another Member State.
5.4. Response time of the tax authorities to fraud

The fourth category of measures aimed at combating missing-trader fraud concerns measures that have the effect of reducing the response time of the tax authorities to missing-trader fraud by improving the information system (such as the VIES), increasing cooperation, speeding up the exchange of information between Member States and making a proper risk analysis of the information available. Generally, by their nature, tax audits and administrative cooperation focus on events that occurred in the past, i.e. the result of those instruments come too late to prevent missing-trader fraud.

The only way to keep up with fraudsters or dissuade them from setting up fraudulent schemes is to detect and stop VAT fraud at source and to prevent bona fide companies from unconsciously and unwillingly getting involved in VAT fraud. Successful fraud prevention could be achieved by adopting a real-time VAT collection system but also by ensuring that bona fide companies are informed about the compliance status of their suppliers before they pay VAT to what may turn out to be a fraudster. As the recent fraud involving CO2 certificates has demonstrated, the existing methods aimed at combating missing-trader fraud are insufficient to trace even the simplest forms of missing-trader fraud in time. A substantial reduction of missing-trader fraud could be achieved if the tax authorities would simply exchange and publish basic information relating to registered businesses, which may even be possible without amending the current regulatory framework.

5.4.1. Basic information on businesses

Much information that would be needed to prevent missing-trader fraud is already available at national level. Specific information must even be available under the VAT Directive, such as the VAT-exclusive value of inputs and outputs, and specification of individual businesses’ intra-Community supplies derived from their EU sales lists. Other information is only available in specific Member States, such as specification of individual businesses’ intra-Community acquisitions and of their domestic purchases and sales. Member States also dispose of other information, such as whether individual businesses have a positive or negative net VAT liability position, and information as regards their filing compliance, audit status and bank account number.

However, the type of information that is available, the frequency by which it is updated and the way it is stored differ from Member State to Member State. The absence of common standards and concepts and the use of different languages make it extremely difficult to exchange detailed information and prevent it from being misinterpreted.

5.4.2. Information necessary to limit fraud

The critical stage of a successful missing-trader fraud scheme is when the customer pays VAT to his supplier and deducts that amount as input VAT. At that time, the tax authorities are unaware of the transaction and, if the transaction is not subject to the reverse charge mechanism or zero rate, it is up to the customer to ensure that he does not pay VAT to a fraudster. However, bona fide customers have no or only limited means to check the VAT compliance of their suppliers. By contrast, the tax authorities possess full information on the payment and reporting behaviour of domestic businesses and they should find an efficient way of assisting bona fide businesses to avoid the situation that they pay VAT to non-compliant suppliers (potential fraudsters).

Inspiration to solve the customer’s lack of information can be found in the fight against social security contribution and tax fraud in the construction sector in Belgium. Customers can find, on a website of the Belgian tax authorities, basic information as to whether or not individual building subcontractors are tax compliant. If the supplier is not compliant, the customer must pay part of the invoice directly to the tax authorities, which is in effect a conditional split-payment method.

The VIES could be used in a similar manner as a source of information. Member States could agree that the VIES reports a VAT identification number as being “technically invalid” (flag the number as being assigned to a “high-risk business”) if the business concerned has, for example, filed two VAT returns late or has a serious payment backlog (for reasons other than legal disputes). Businesses will still be able to enter into transactions with “flagged” businesses but if they pay VAT to them and it turns out that the supplier is a missing trader, the customer cannot claim that he could not have known that, by his purchase, he was participating in a transaction connected with fraudulent evasion of VAT.

Member States could also use the VIES as an instrument for making missing-trader fraud more difficult by linking VAT identification numbers to a specific bank account, and by ensuring that businesses cannot be registered under more than one VAT identification number and cannot file multiple VAT returns.

In an ideal situation, before paying VAT to their suppliers, businesses would be able to check online whether their business partners have reported the transaction through a domestic sales list. If they have reasonable doubt about the supplier’s compliance, diligent businesses will be able to prevent the situation that the tax authorities lose any VAT.

The VIES could also be used to combat VAT refund fraud and export fraud. The critical stage of a successful re-

51. See also BusinessEurope’s “Position Paper on the Creation of Eurofisc and The Fight against VAT Fraud” of 27 April 2010.
53. See Chapters 5 and 6 of Title XI of the VAT Directive.
fund fraud scheme is when the tax authorities accept that specific invoices relate to real purchases, and the critical stage of a successful export fraud scheme is when the tax authorities accept that specific transactions are actually zero-rated exports or intra-Community supplies of goods. In order to make correct decisions, the tax authorities need “external” sources to cross-check the correctness of the invoices. Other authorities in the same or in another Member State possess the necessary information, but making a formal request for detailed information relating to specific transactions may be too burdensome and, if the information is provided, it may be too late. Also in this respect, the VIES could be a useful source of information if it would at least contain information as to whether or not registered businesses:
- have filed all required VAT returns and EU sales lists in the past 12 months;
- have filed “nil VAT returns” in the past 12 months;
- have significant VAT payment backlogs; and
- have declared intra-Community acquisitions in conformity with the corresponding EU sales lists.

It is important that the information to be included in the VIES is not too detailed because detailed information may give rise to confusion and misinterpretation.

5.4.3. The role of Eurofisc

Eurofisc is a decentralized network without legal personality. It is intended to promote and facilitate multilateral cooperation between Member States in the fight against VAT fraud and a swift exchange of information between Member States. 53

In the framework of Eurofisc, Member States must establish a multilateral early-warning mechanism for combating VAT fraud. Member States will also coordinate the swift multilateral exchange of targeted information in the subject areas in which Eurofisc will operate. Member States will participate in the Eurofisc working fields of their choice. The Commission provides Eurofisc with technical and logistical support but has no access to the information that is exchanged through this network. 56

It seems that the role of Eurofisc in the fight against fraud is currently interpreted narrowly. Even the Commission seems to take the position that Eurofisc should only be used to exchange targeted information on specific fraudulent businesses and transactions in a non-automated way. Only when Member States suspect fraud can the related information be shared with other Member States on a voluntary basis. This approach seems highly subjective and the criteria for sharing information lack clarity and will undoubtedly vary from Member State to Member State.

There is, however, nothing in Regulation 904/2010 that would prevent Member States from also using Eurofisc to automatically exchange basic information that is objectively associated with non-compliance or fraud. In our opinion, optimal administrative cooperation no longer depends on a unanimous decision of the EU Council, but simply on the willingness of the national tax authorities or, to a certain extent, of the national legislators to systematically release and disseminate basic information on the non-compliance of domestic businesses. The tax authorities now have a legal basis for providing to each other specific information on abnormal situations or abnormal behaviour of businesses. It is up to the national authorities to decide how they will use the information received from abroad.

6. Proportionate Measures against Missing-Trader Fraud

Under Art. 5 TEU, 57 the use of Union competences is governed by, inter alia, the principle of proportionality, which means that the content and form of Union action, including the VAT Directive, must not exceed what is necessary to achieve the objectives of the Treaties. Under the principle of proportionality, measures imposing financial charges on economic operators are lawful, provided that the measures are appropriate and necessary to achieve the objectives legitimately pursued by the legislation in question. Of course, where they have a choice between different appropriate measures, the authorities must use the least onerous measure and the charges imposed must not be disproportionate to the aims pursued. 58

As regards judicial review of compliance with the principle of proportionality, the ECJ has accepted in Vodafone 59 that, in the exercise of the powers conferred on it, the Union legislature must be allowed a broad discretion in areas in which its action involves political, economic and social choices and in which it is called upon to undertake complex assessments and evaluations. Thus, the criterion to be applied is whether a measure adopted in such an area is the only or the best possible measure. The lawfulness of a measure can be affected only if, having regard to the objective which the competent institution is seeking to pursue, the measure is manifestly inappropriate. 60 However, although it has a broad discretion, the

56. Art. 35 of Regulation 904/2010 (see note 55).
59. ECJ judgment of 8 June 2010 in Vodafone Ltd, Telefónica O2 Europe plc, T-Mobile International AG, Orange Personal Communications Services Ltd v. Secretary of State for Business, Enterprise and Regulatory Reform, Case C-58/08.
Union legislature must base its choice on objective criteria. Furthermore, in assessing the burdens associated with various possible measures, the Union legislature must examine whether objectives pursued by the measure chosen are such as to justify even substantial negative economic consequences for certain operators.61

The assessment of whether or not certain obligations imposed by public authorities are proportionate can change over time due to changed circumstances and the availability of new and better methods to achieve specific results. Public authorities have the responsibility to permanently monitor obligations imposed in the past and, if necessary, reconsider them under the principle of proportionality.

The foreseeable explosion of missing-trader fraud in the European Union under the “1993 transitional VAT regime” has led to an accumulation of administrative obligations and anti-fraud measures, which are ineffective for combating or preventing that type of fraud. Those measures have led to disproportionate compliance cost on businesses and to legal uncertainty. However, the changed legal environment may have removed obstacles that prevented the tax authorities in the past from making the VAT system and VAT administration more business friendly.

The question arises of whether, for the purposes of refusing a business the deduction of VAT in respect of specific purchases, the tax authorities can still rely on the “knowledge test”62 if they already knew or could have known that the business’ supplier was involved in fraud. Under the principle of proportionality, the tax authorities may also be required to provide bona fide businesses with the means they need to protect themselves against the risk of participating in a transaction connected with fraudulent evasion of VAT. Those means require a better exchange of information between the national tax authorities.

Since 1993, 15 new Member States have joined the European Union but decisions on tax legislation must still be taken unanimously, which has made it increasingly difficult to amend the formal rules laid down by the VAT Directive. However, an external event, such as an ECJ judgment, could change the entire situation. The ECJ has played an important role in the history of the development of the EU VAT system. Adoption of the First and Second Directives can to a large extent be attributed to the judgment of the ECJ in Lutticke.63 In combination with a judgment of the German Constitutional Court,64 the two courts based their decisions on the legislation that existed at that time and they effectively forced the EU Council to adopt the first two VAT Directives and introduce the new tax, even though businesses and tax authorities were still in the process of adapting their procedures to the new tax and despite strong political opposition of some Member States to the new tax. There is no reason why the ECJ should not again change the VAT policy in the European Union.

7. Conclusions

Times change and rules that once were proportionate and effective to cope with fraud may have become disproportionate and ineffective to cope with new types of fraud. When the “transitional VAT regime” was introduced in 1993, Member States knew that they could expect substantial missing-trader fraud within the European Union. At that time, tools for effectively combating missing-trader fraud were not yet available, which has led to an accumulation of anti-fraud measures, high compliance burdens on businesses and uncertainty for the business community.

Under the EU principle of proportionality, Member States have a responsibility to keep existing rules proportionate by making use of newly available legal and technological means. By centralizing certain information and providing it to the right persons in time, Member States could make the burdens of the VAT system proportionate again, without having to give up their control of the collection of the tax. Eurofisc could play a role in the process of restoring the proportionality of the VAT system if Member States would make full use of its potential. If Member States make proper use of the instruments they dispose of, victims of missing-trader fraud can now respond to the accusation that “they knew or should have known that, by making their purchase, they were participating in a transaction connected with fraudulent evasion of VAT” by saying to the tax authorities: “you should also have known of the fraud and what have you done to prevent it?”


62. Businesses who “knew or should have known” that, by their purchase, they were participating in a transaction connected with fraudulent evasion of VAT (see note 9) cannot deduct the VAT mentioned on the related invoice.


64. By its judgment of 20 December 1966, Nos. 1 Brv 320/57 and 1 Brv 70/63, the Federal Constitutional Court of Germany decided that the turnover tax existing at that time in Germany was discriminatory, and the Constitutional Court ordered the German government to introduce a new tax system within two years. The EU Council adopted the Second Directive on 11 April 1967 and the new legislation based on that Directive was adopted in Germany on 29 May 1967; the new legislation entered into force on 1 January 1968.

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Towards a Simpler, More Robust and Efficient VAT System by Levying VAT at EU Level

At the end of 2010, the European Commission launched a public debate on the future of the EU VAT system. In this article, the authors explain that conversion of the VAT system into a true EU tax is the most appropriate approach. The description of their proposed EU VAT system does not pretend to be complete but gives a good general idea of the authors’ approach. Even if it appears that adoption of the proposed EU VAT system is not possible for political or practical reasons, specific elements of the authors’ proposal are still of use.

1. Introduction

At the end of 2010, the European Commission launched a public debate on the future of the EU VAT system by publishing a Green Paper. 1 In the Green Paper, the Commission raises a number of issues that currently hamper the proper functioning of the VAT system, and also formulated a number of suggestions aimed at remedying the situation.

The Commission felt it necessary to launch this public debate for four reasons:
(1) businesses are confronted with complex VAT rules, resulting in unacceptable administrative burdens;
(2) domestic and intra-Community transactions are treated differently for VAT purposes, and the way in which VAT rules apply in practice diverges across the European Union, which has the effect that VAT is an obstacle to the functioning of the internal market;
(3) a reform of the current VAT system is necessary to maximize revenue collection and to end the susceptibility of the system to fraud; and
(4) the technological and economic environment has changed and continues to change rapidly, and the EU VAT system has not been able to keep up with this evolution.

As academics and concerned tax practitioners, we felt the need to participate in this public debate. However, we have written this article from an academic perspective only; political aspects play only a minor part. This article reflects what we consider to be an appropriate VAT system for the European Union, which would contribute considerably to resolving the problems mentioned above. The description of the proposed VAT system does not pretend to be complete. It only addresses the main conceptual elements, which means that many questions will remain unanswered. Nevertheless, we trust that, even if it appears that adoption of the proposed EU VAT system is not possible for political or practical reasons, specific elements of the proposal are still of use.

2. VAT as an EU Tax

VAT was introduced in the European Union in 1968 to support the development of the single market. However, the main problem is that it has never developed into a uniform system. In practice, 27 national VAT systems exist and each system has its own VAT rates, exemptions, administrative obligations, etc. As a consequence, the current VAT system significantly hinders intra-Community trade: multinational businesses find it difficult to be compliant in all Member States, and tax authorities face difficulties in gathering information from their colleagues abroad, in order to efficiently monitor and control intra-Community transactions.

The optimum solution for the proper functioning of the internal market requires transforming VAT into an EU tax (“EU VAT model”), i.e. a tax that is not only regulated on the basis of an EU VAT Regulation, 2 but also collected at EU level. A true EU VAT system would have the effect that businesses would only have to deal with a single set of VAT rules throughout the entire European Union. For the purposes of carrying out transactions in the entire European Union, businesses would, inter alia, use a single EU VAT number and file a single EU VAT return and recapitulative statement, and apply the same VAT rates and exemptions, regardless of whether the transaction is a domestic or intra-Community supply. Under the proposed EU VAT model, tax authorities would be able to shift their resources from tracing infringements of formal obligations to carrying out audits, exchanging best practices, joining forces to combat fraud, etc. Such a change would significantly help businesses and tax authorities to focus on their core activities, i.e. generating trade and raising tax revenues, respectively. It seems to be the only

* Dr Kenneth Vyncke is an affiliated senior researcher at K.U.Leuven, professor of VAT at the Royal Military Academy (Brussels), and Manager with Deloitte Brussels. Dr Axel Cordewener is professor of Tax Law at K.U.Leuven and lawyer at the Cologne and Brussels bars. Dr Luc De Broe is professor of Tax Law at K.U.Leuven and partner of Laga Brussels. The authors would like to thank Jasper Bossuyt and Christophe De Backere for their assistance.
way to really move towards a simpler, more robust and efficient VAT system.

Transforming VAT from a direct source of income for Member States into a direct source of income for the European Union requires a system for redistributing total VAT revenues. In this respect, it should be born in mind that VAT is a major source of income for all Member States: in 2008, 21.4% of national tax revenues were derived from VAT. Instead of the current system under which Member States transfer part of their VAT revenues to the European Union, the European Union would share total VAT revenues with the Member States, on the basis of a distribution formula, just like other federal countries share tax revenues. For example, in Canada, the federal government has agreed with five provinces to apply a harmonized sales tax (HST), which replaced federal GST and provincial sales tax (PST). HST is collected at federal level and applies at rates varying from 12% to 15%, which consist of a federal tax component of 5% and a provincial tax component of 7%, 8% or 10%. In Germany, a single VAT is levied at national level and part of the total revenues is allocated to the Länder (states) on the basis of a revenue sharing formula.

Member States would have to decide what percentage of total VAT revenues would be allocated to the European Union. For example, in China, 75% of the VAT revenues are allocated to the central government and the other 25% to the provinces. By contrast, all GST revenues accrue to the states in Australia, whereas, in Switzerland, there are no rules on revenue sharing.

Revenue sharing already occurs in the European Union: for example, between the United Kingdom and the Isle of Man, and between France and Monaco. Total VAT revenues could be shared between the European Union and the Member States on the basis of a fixed revenue sharing formula or on the basis of consumption statistics. The latter approach seems more appropriate for a consumption tax. However, those statistics must be reliable and the underlying data would have to be checked by the Commission to ensure that any possible manipulation is immediately neutralized.

3. Charging and Collecting VAT

3.1. Taxation of intra-Community trade

Under the current VAT system, businesses only charge VAT to other businesses in respect of domestic supplies of goods and services. In respect of intra-Community transactions, business customers must account for VAT, in respect of goods, on the intra-Community acquisition and, in respect of services, under the reverse charge mechanism. Treating domestic and intra-Community transactions differently for VAT purposes is inconsistent with the concept of the internal market.

The current arrangements for taxation of intra-Community transactions were meant to be transitional. However, the Commission has never succeeded in replacing them by a definitive system based on the origin principle. Its attempts were based on the idea that VAT is a national source of revenue, which made it necessary to transfer the VAT collected in the supplier’s Member State to the customer’s Member State (clearing house) in order to allow business customers to recover the tax in their own Member States. The most obvious advantages of the Commission’s proposal for the definitive system are that domestic and intra-Community transactions are treated in the same manner and that suppliers are only confronted with the VAT rules applicable in their own Member States. Moreover, the Commission’s proposal would enable final consumers to take advantage of differences in VAT rates by making their purchases in the Member State with the lowest VAT rate. As compared to the current system, the Commission’s proposal would have the effect that VAT on B2B intra-Community transactions must be financed (either by the supplier or the customer).

By contrast, our proposal for an all-stage EU VAT system would make the question of whether the system is based on the origin or destination principle irrelevant. The supplier would have to charge VAT at the EU rate on all domestic and intra-Community transactions, and the reverse charge mechanism and the concept of intra-Community acquisitions of goods would disappear.

The EU VAT model would have the advantages of the Commission’s origin-based system and would not have many of its disadvantages. Under the Commission’s origin model:

- VAT rates were to be harmonized to a high degree in order to limit distortion of competition between Member States, especially with respect to purchases by final consumers. Under the proposed EU VAT model, such distortions of competition do not exist because all transactions would be subject to the same EU VAT rate;
- a clearing house system was required to ensure that VAT accrues to the Member State of consumption. Under the proposed EU VAT model, Member States would have to agree on a distribution formula for revenue sharing; and
- Member States had to rely on each other to collect a substantial part of their VAT revenues. Under the proposed EU VAT model, Member States would only have to provide information for the purposes of calculating the distribution formula. If Member States did not trust the statistics provided by the other Member States, calculation of the distribution for-

8. Questions 1 and 2 in the Green Paper (see note 1).
9. Under Art. 402 of the VAT Directive, these arrangements “shall be replaced by definitive arrangements based in principle on the taxation in the Member State of origin of the supply of goods or services.”
mula could not be done by the Commission, although that may not be the best way forward.

The EU VAT model would also be acceptable to businesses. Businesses particularly fear the suggestions in the Commission’s Green Paper relating to taxation of intra-Community transactions. Although the Commission claims to pursue a reduction of administrative burdens (see 5.1.), businesses believe that some of the Commission’s suggestions would lead to a substantial net increase in the financial burdens. They point out that Member States should bear the burden of VAT, not businesses.

Under the EU VAT model, businesses would no longer be confronted with 27 different VAT systems, but only with a single EU VAT system, which would considerably decrease administrative burdens and, therefore, make it an acceptable solution. Consequently, this model would solve one of the major issues addressed by the Commission in its Green Paper, i.e. the complexity of the current VAT system.

Under the current VAT system, the applicable rules depend on the nature of the transaction (supplies of goods or services), the type of goods (new means of transport, excise duty goods, etc.), the type of services (various categories or services are subject to different place-of-supply rules), the status of the supplier (small and other businesses), the status of the customer (businesses or final consumers) and the destination of the supply (destination in the same or in another Member State, or outside the European Union). Under the EU VAT model, all transactions carried out by businesses established in the European Union are subject to EU VAT, except where the goods or services are effectively used and enjoyed outside the European Union. Transactions carried out by businesses established outside the European Union are only subject to EU VAT, if the goods or services are effectively used and enjoyed in the European Union. In the latter case, the VAT liability should be shifted as much as possible to the EU customer in order to protect EU VAT revenue. Definition of “effective use and enjoyment” of goods could be based on the physical destination of the goods. For services, definition of “effective use and enjoyment” requires specific criteria. However, that issue is not new and currently exists under Art. 59a of the VAT Directive.

3.2. VAT Collection

In its Green Paper, the Commission presented four models for improving the way VAT is collected: the “split payment”, “central VAT monitoring database”, “secure VAT data warehouse”, and “certification” models. The feasibility of these rather complicated models is doubtful. In addition, they all require considerable investment by both businesses and tax authorities and most models are probably ineffective in preventing missing-trader and suppression fraud.

As there would be a significant reduction in the administrative burdens under the proposed EU VAT model, VAT can remain an “indirect” tax, i.e. a consumption tax collected by businesses and remitted to the tax authorities based on “self-assessment”, under supervision of the tax authorities.

3.3. Deductions

Recovery of input VAT is a fundamental principle of VAT, as it preserves the neutrality of the VAT system. Consequently:

1. flat-rate restrictions should be abolished. Limitations on the recovery (deductibility) of input VAT should be handled with care, as they have an adverse impact on the neutrality of VAT for the businesses concerned. VAT on goods and services used for taxable economic activities should be fully deductible. Only where goods or services are also used for non-business purposes, businesses should themselves limit, in a fair and reasonable way, their recovery of related VAT, under supervision of the tax authorities. Flat-rate restrictions are not a useful option in this respect because they cannot possibly reflect the economic reality for individual businesses. Member States should no longer apply restrictions on expenditures relating to cars, events, hotel accommodation, and restaurant and catering services because these expenditures are necessary to run a business properly: customers must be entertained, staff must be rewarded, etc. Such restrictions are exclusively aimed at generating additional VAT revenues and are not in line with the fundamental idea that VAT must be neutral within the production and distribution chain;

2. VAT should be chargeable and deductible on the basis of payments (cash accounting). Under the current VAT system, VAT may become chargeable for suppliers and deductible for customers at the time the supply is made, the related invoice is issued, the payment is received, etc. Under the EU VAT model, VAT would become chargeable and deductible depending on actual payments, just like the regime that currently applies to domestic services in France. Cash accounting has several advantages: in the case of late payment, suppliers do not have to finance the VAT, no adjustments are necessary if customers become insolvent and, in the case of hire purchase, VAT becomes due as the customer pays the instalments;

3. input VAT should be recoverable on the basis of an economic approach. The right to deduct input VAT should no longer be based on a direct link between inputs and output transactions but, instead, on an economic approach. Consequently, Baxi and Loyalty Management should be allowed to recover VAT on the costs incurred in the framework of loyalty.

10. Question 30 in the Green Paper (see note 1).
11. Questions 9 and 10 in the Green Paper (see note 1).
12. Germany has recently broadened the cash accounting regime for taxing transactions of small enterprises and liberal professionals (Ist-Besteuerung). However, those entrepreneurs can still deduct input VAT on an accrual basis.
13. ECJ judgment of 7 October 2010 in Loyalty Management UK Ltd v. Commissioners for Her Majesty’s Revenue and Customs and Baxi Group Ltd v. Commissioners for Her Majesty’s Revenue and Customs, Joined Cases C-53/09 and C-55/09.
schemes aimed at rewarding loyal customers. Auto Lease Holland\textsuperscript{14} should be allowed to recover VAT on the fuel costs incurred in the framework of its car leasing activities, etc. This economic approach is already partly reflected in the case law of the Court of Justice of the European Union (ECJ), for example in its judgments relating to transactions involving shares.\textsuperscript{15}

3.4. International services\textsuperscript{16}

International services, such as electronically supplied B2C services (downloading software or music through the Internet), are becoming increasingly important in the “globalized world” but they are difficult to tax, especially where the supplier is established outside the European Union. International cooperation between tax authorities would be the best way forward to address these problems.

4. Broadening the Tax Base

4.1. Public bodies and holding companies\textsuperscript{17}

The criteria for treating public bodies as taxable persons should be reversed: those bodies should no longer be outside the VAT system if they act as public authorities, with specific exceptions,\textsuperscript{18} but they should be treated as taxable persons if their activities may be in competition in their national market with the activities of private businesses. In view of increasing privatization, the latter approach would be more practical. Consequently, public bodies should in principle be treated as taxable persons, just like in Australia and New Zealand.

Unlike the ECJ decided in Polysar,\textsuperscript{19} where they form part of a corporate group that carries out taxable activities, holding companies should be able to recover input VAT, even if they do not themselves carry out any taxable activity. Also in this respect, the economic approach should be decisive. There is no doubt that holding companies fulfil an essential function within corporate groups. If all its subsidiaries carry out economic activities subject to VAT, the holding company should be allowed to recover input VAT, just like in Switzerland.

4.2. Exemptions\textsuperscript{20}

“VAT exemptions are a major intellectual error”.\textsuperscript{21} VAT exemptions in B2B relationships indeed infringe a fundamental principle of VAT, as they undermine the neutrality of the system. As the Commission mentioned in the Green Paper, “if VAT were the neutral tax on consumption that it is supposed to be, exemptions would not exist”. It can thus be argued that exemptions are not in line with the logic of VAT. Although the arguments in support of the current VAT exemptions may have been valid when the Sixth Directive was adopted, many existing VAT exemptions have become controversial 40 years later in the light of economic and technological changes. Moreover, broadening the tax base by reducing the number of exemptions would make the tax more efficient and more neutral. It would also make it possible to reduce the VAT rate.

VAT exemptions should be abolished, and all supplies of goods and services, including supplies in so-called “hard-to-tax sectors” (financial services, insurance and real estate transactions) should be subject to VAT. Concessions in the form of VAT exemptions only add to the complexity of a VAT system, decrease revenue and generally increase compliance risks (in the form of tax avoidance schemes), administrative costs and compliance burdens.\textsuperscript{22} By comparison, New Zealand applies only four VAT exemptions (to leases of residential property, fine metals, donated goods and services sold by non-profit organizations; certain B2B financial transactions are zero rated and other financial services are exempt – including life insurance and reinsurance). Australia has only five VAT exemptions.

Substantial price increases that would occur when exempt transactions become subject to VAT can be prevented by zero rating B2B transactions, whereas the standard rate would apply to B2B transactions. By comparison, Australia applies the zero rate to 13 categories of goods and services, including most food and beverages, most health care services (including health insurance), education, childcare, etc.

Finally, New Zealand is an inspiring example of how a broad tax base can be achieved. In addition to the four VAT exemptions mentioned above, the country applies the zero rate to six categories of supplies: the transfer of a business as a going concern, certain sales of gold, silver and platinum, specific supplies made by local authorities, supplies of financial services and land to GST-registered businesses, and certain transactions in relation to emission units; of course, exported goods and services are also zero rated. New Zealand demonstrates that a VAT system with a limited number of VAT concessions is possible.

4.3. Rates\textsuperscript{23}

Under the proposed EU VAT model, VAT would be levied at EU level, which means that the rate structure would

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\textsuperscript{16} Questions 3 to 5 in the Green Paper (see note 1).

\textsuperscript{17} Questions 3 to 5 in the Green Paper (see note 1).

\textsuperscript{18} Under the current VAT system, public bodies are not regarded as taxable persons in respect of activities in which they engage as public authorities. However, they are considered to be taxable persons where their treatment as non-taxable persons would lead to significant distortions of competition and, in any case, in respect of the activities listed in Annex I to the VAT Directive.


\textsuperscript{20} Questions 6 to 8 in the Green Paper (see note 1).


\textsuperscript{23} Questions 19 and 20 in the Green Paper (see note 1).
also be determined at that level. The rate structure would at least comprise the standard rate and the zero rate. As regards the question of whether there is any need for reduced rates, it should be noted that no reduced rates apply in Australia and only one “effective” reduced rate applies in New Zealand.

At first sight, reduced rates seem indispensable, as they are used as a policy instrument to keep basic necessities, such as food and clothing, social housing and medical appliances, cheaper. However, there are several arguments in favour of abolishing reduced rates:

- reduced VAT rates are not the only and/or most efficient instruments to achieve politically desirable results. Governments may grant subsidies (e.g. food coupons), apply income tax deductions (e.g. for certain construction costs), organize third-party payment systems (e.g. social services), etc. Direct measures can be more targeted towards certain categories of citizens who actually need financial support;
- in order to increase legal certainty and reduce administrative burdens, the categories of goods and services to which a reduced rate applies should be limited. However, political preferences and targets differ considerably from Member State to Member State and they also change over time. Therefore, changing the scope of application of reduced rates laid down by EU law is problematic because it requires a unanimous decision of all Member States;
- the additional revenue resulting from the abolition of reduced rates would make it possible to finance tailored policy measures and/or reduce the standard rate;
- comparable goods and services should be taxed at the same rate, which is currently not always the case (e.g. printed books versus e-books).

Taking into account the inefficiencies of reduced rates and the lack of real added value compared with other policy instruments, reduced rates are to be abolished under the EU VAT model.

5. Reducing Red Tape

5.1. Reducing administrative burdens and streamlining VAT obligations

Levying VAT at EU level automatically means a significant reduction in administrative costs. Businesses operating in several Member States currently face a patchwork of national VAT obligations. The reporting obligations differ considerably, which is an enormous burden on businesses engaged in cross-border trade. Under the proposed model, all obligations would be streamlined. Businesses would only have to comply with administrative obligations in a single Member State, preferably that where their head office is located. The national tax authorities would still play an important part as a point of contact for businesses and would be responsible for auditing them.

As regards administrative obligations, two major improvements of the current system are necessary:

- it would be very useful for businesses if they could use an invoice template, which would enable them to process purchase invoices manually or electronically more efficiently;
- it would be very useful for the tax authorities if, in addition to EU VAT returns, businesses had to file periodic sales and purchase lists, containing the VAT numbers of their customers and suppliers, respectively, together with the value of the sales and purchases. These lists would then automatically be compared at EU level and mismatches should be investigated by the corresponding local tax office(s).

5.2. Small businesses

Under the current VAT system, Member States apply various special arrangements (exemptions, flat-rate schemes, and schemes for graduated tax relief) in order to relieve small businesses of certain administrative burdens.

Registration thresholds may however create an incentive for businesses to underreport their transactions or to split up their activities in order to apply the registration threshold multiple times. On the other hand, registration thresholds also provide benefits to the tax authorities: fewer businesses are registered, fewer VAT returns must be processed, fewer requests for information must be answered, fewer VAT audits must be carried out, etc. Currently, small businesses generate a great deal of work for the tax authorities, while their contribution to total VAT revenues is very small.

Balancing the advantages and disadvantages of special schemes for small businesses, the proposed EU VAT model contains a registration threshold only, which should be based on annual worldwide turnover. The registration threshold should be set at EU level, based on a cost-benefit analysis.

5.3. Branches and subsidiaries

Under the current VAT system, companies operating under an organizational structure of (legally dependent) branches are treated differently from those operating with (legally independent) subsidiaries. Cross-border supplies of services between branches are considered to be internal transactions and, therefore, outside the scope of VAT,

24. Currently, Member States may apply either one or two reduced rates, which may not be less than 5%, but, due to transitional arrangements, several Member States apply rates lower than 5% and more than two reduced rates. The resulting patchwork of VAT rates leads to a significant administrative burden on multinationals.
25. In New Zealand, long-term stays in commercial dwellings, such as hotels or nursing homes, are taxed at the standard rate on 60% of the total price.
26. Questions 21 to 23 in the Green Paper (see note 1).
27. Questions 24 to 26 in the Green Paper (see note 1).
28. Businesses whose an annual turnover is below a certain threshold are entitled to exempt their transactions from VAT. They are then not allowed to deduct input VAT. Alternatively, they can opt for taxation.
29. Businesses pay VAT on their turnover at a flat rate, which is the balance of their normal VAT liability and their average right to deduct input tax.
30. If their annual turnover is above a certain turnover threshold, businesses pay an increasing part of their normal VAT liability, until they reach a second, higher turnover threshold.
31. Question 28 in the Green Paper (see note 1).
6. Administering the VAT System

6.1. Legal process

Transforming VAT from a national tax into an EU tax implies that the legal process must be harmonized and streamlined across the Member States.

Under the current VAT system, VAT is mainly regulated on the basis of a Directive, leaving Member States the choice of form and method to achieve the common goals. However, the Directive also provides Member States with numerous options, which considerably contributes to the complexity of the system. Under the proposed model, VAT would be levied on the basis of a Regulation, which is directly applicable in all Member States. In this respect, the Community Customs Code is an inspiring example.

The VAT Regulation would no longer contain derogations for individual Member States.

Levying VAT on the basis of a Regulation instead of a Directive would prevent Member States from being late in transposing EU VAT law into national legislation and making transposition errors.

In order to avoid the need for regular amendment, which requires a unanimous decision of the EU Council, the proposed VAT Regulation would only contain the basic features of the VAT system, such as the concepts of taxable persons, taxable transactions, taxable amounts, tax rate(s) and the right to deduct input VAT.

Practical details of the EU VAT system, including administrative rules and procedural matters, should be laid down by binding implementing decisions to be made by the European Commission. This model is based on the Belgian VAT legislation: basic features are laid down by the VAT Code, and the practical details by Royal and Ministerial Decrees. This model would offer the required flexibility, since unanimity is not necessary for changing practical details that do not affect VAT revenue.

The third level of the regulatory framework of the EU VAT model would consist of EU rulings, which provide legal certainty to businesses in individual cases. To that end, a rulings committee in VAT matters should be set up at EU level. This function could be assigned to the VAT Committee, as a representative body of all Member States, which would then be authorized to make binding rulings in VAT matters. To increase its efficiency, the rulings committee would be able to rely on local tax authorities to process requests for rulings, verify consistency of new rulings with previous rulings, and draft the rulings. However, the final decision would be taken at EU level, by the committee.

The rulings committee should be obliged to deliver the rulings within a specific period of time. In view of the numerous cases that could potentially be presented to the rulings committee, thus potentially depleting its resources and reducing its efficiency, its field of activity may have to be limited to future transactions, in order to prevent the committee from interfering in pending disputes between applicants and local VAT authorities, or to difference of opinion between two or more Member States on the interpretation of legal provisions. The rulings should be published systematically.

Finally, the rulings committee could be supplemented by an “Express Answering Service” (EAS), such as that which has proved its value in Austria. EAS is a special service relating to inquiries from businesses about international tax cases. The replies given by the Austrian Division for International Tax Affairs are greatly appreciated by businesses and reflect the general position of the Federal Ministry of Finance relating to international tax scenarios. Since 1991, the Austrian EAS has answered more than 2,800 inquiries.

6.2. Dialogue between tax authorities and businesses

Both businesses and tax authorities play a crucial part in a VAT system: businesses collect the tax and tax authorities supervise the collection process. Businesses and tax authorities have a common interest in combating VAT fraud. Therefore, it is extremely important that both parties are on the same wavelength. In order to achieve that goal, a permanent dialogue between businesses and tax authorities, in the form of a platform for exchanging views on existing and proposed new legislation, as well as its practical implications, would be necessary. Businesses should be given a voice in the legislative process. Too often, new VAT rules are introduced without paying attention to IT consequences. Many businesses currently work with ERP systems, including invoicing and bookkeeping systems, that require complex adaptations when the legislation changes. Businesses need a stable and reliable legal environment.

Finally, best practices in the field of VAT should be pooled in the European Union.

32. Questions 13 to 16 in the Green Paper (see note 1).
33. Question 32 in the Green Paper (see note 1).
34. Enterprise resource planning.
6.3. Other issues

Two other issues need particular attention in the framework of a new VAT system.

Administrative activities, such as allocating VAT numbers, processing VAT returns, performing VAT audits, etc., should be regulated at EU level but carried out at national level for various reasons: language, distance, habits, trust, knowledge, experience, etc. A harmonized and centralized administration is probably not the most efficient solution.

Procedural matters, such as statutes of limitations, penalties, late-payment interest, etc. should be regulated at EU level, in order to guarantee equal treatment of all businesses in the European Union. Moreover, penalties and late-payment interest should be revised in the light of the proportionality principle. Currently, specific sanctions are disproportionate to the infringement. For example, input VAT recovery may be denied on the ground of a deficiency of the related invoice, even if the invoice relates to a transaction that is subject to the reverse charge mechanism and the VAT has properly been declared. Such practices only generate additional VAT revenue.

35. Question 33 in the Green Paper (see note 1).
Unjust Enrichment under EU VAT

Under the principle of unjust enrichment, Member States may refuse to repay indirect taxes to traders on the ground that they have already shifted the burden of the tax to a third party and would be unjustly enriched by receiving the tax from the tax authorities. In a large number of judgments, the ECJ has described the terms and conditions under which Member States may apply the principle of unjust enrichment. In this article, the author explains that those conditions are significantly different depending on whether the tax refund concerns a tax that Member States imposed in violation of EU law or VAT charged by a trader to his customer by mistake.

1. Introduction

The characteristic feature of an indirect tax is that the person who remits the tax to the authorities is not the person who is presumed to bear the burden of the tax and, depending on the design of the tax, the person who has remitted the tax is presumed or sometimes even legally required to recharge the tax to his customers by including it in the selling price of goods or services supplied to those customers or, in the case of VAT, by adding the tax to the tax-exclusive price for supplies of goods or services.

Within the category of indirect taxes, VAT takes a special place because, although it is designed as a tax on final consumption of goods and services, the tax applies at all subsequent stages of the process of production and distribution and, in order to prevent accumulation of the tax, the VAT system is equipped with an input tax deduction mechanism. One of the conditions for deduction of VAT is that the tax is separately mentioned on a VAT invoice. In order to keep the deduction mechanism manageable for the tax authorities, Art. 203 of the VAT Directive provides that any person who mentions VAT on an invoice must remit it to the tax authorities. In this context, the term “any person” was designed to have the broadest possible scope. However, according to the Court of Justice of the European Union (ECJ), non-taxable persons who have mentioned VAT on an invoice can escape from that liability under certain circumstances.

2. Correction of Mistakes

Taxable persons who have mentioned VAT on an invoice by mistake can escape from the liability to remit that amount to the tax authorities by correcting the invoice or by taking other measures to prevent the tax authorities from suffering a loss of tax revenues. That correction mechanism appears to be very broad. Even if they mentioned VAT on an invoice for fraudulent purposes, taxable persons are generally entitled to correct their “mistakes”, if they have, in sufficient time, wholly eliminated any risk of a loss of tax revenues. Examples of persons who had made such “mistakes” were Mr Schmeink who had acquired 50% of the shares in a company for which he paid DEM 3.8 million and, in support of an application for an investment grant, had presented that payment as consideration for advisory services. However, the company had never claimed the right to deduct the VAT and, subsequently, returned the pro forma invoice to Mr Schmeink. Similarly, for the purposes of concealing losses in one of his subsidiaries and making profitability appear better than it was, Mr Strobel had issued, to several leasing undertakings, invoices, including VAT, relating to supplies which he had never made. The leasing undertakings paid Strobel’s invoices and, subsequently, Mr Strobel repaid them. The leasing undertakings deducted the amounts of VAT shown on the invoices but, a couple of years later, Mr Strobel voluntarily filed a declaration with the tax authorities setting out the true position.

In its judgment relating to the two above cases, the ECJ observed that the measures which Member States may adopt in order to ensure the correct levying and collection of the tax and to prevent fraud must not go further than is necessary to attain those objectives, and that the measures may not be used in such a way that they would have the effect of undermining the neutrality of VAT. On those grounds, the ECJ concluded that a person who issued an incorrect invoice does not have to demonstrate to the satisfaction of the tax authorities that he has acted in good faith, if he has, in sufficient time, wholly eliminated any risk of a loss of tax revenues. Consequently, adjustment of improperly invoiced VAT cannot be dependent on the discretion of the tax authorities. Member States may only apply the condition that, by charging too much VAT on an invoice, the issuer of the invoice has acted in good faith (truly made a mistake) when the risk of loss of tax revenues has not fully been eliminated. If it transpires that it is no longer possible to cancel deduction of the VAT by the recipient of the invoice and the issuer of the invoice has not acted in good faith, the latter may be held responsible for the loss of tax revenues in order to ensure tax neutrality.

* Tax adviser, the Netherlands.

Also the German trader Albert Collée, who, in order to earn a commercial commission, had disguised intra-Community supplies of 20 demonstration vehicles to a car dealer in Belgium as domestic supplies made to a cooperative car dealer in Germany, was entitled to correct his "mistake" and to zero rate the supplies with retrospective effect. However, by contrast, the ECJ had no mercy with the German car dealer R, who had presented intra-Community supplies of luxurious motor vehicles to Portuguese car dealers as transactions that were subject to the margin scheme, enabling his Portuguese customers to escape taxation in Portugal. In the latter case, the ECJ decided that, although the transactions fulfilled the two conditions for zero rating, R had to account for German VAT on those supplies. It must therefore be assumed that, even if R were to replace the original fraudulent invoices by corrected invoices mentioning German VAT, the Portuguese importers would not be entitled to recover that VAT under the refund procedure. Should the Portuguese importers be entitled to recover the German VAT, it would have been more efficient if the ECJ had allowed R to replace the original invoices by invoices mentioning the zero rate. It is nonetheless rather remarkable that the ECJ allowed the tax authorities to use the VAT in that case to punish the fraudulent German supplier.

3. Correction of Invoices

If they discover that they have made a mistake in drawing up an invoice relating to a transaction, honest businesses will correct the invoice on their own initiative and issue either a supplementary invoice or a credit note. However, Stadeco clearly did not belong to that category of businesses.

Stadeco was established in the Netherlands and operated a business of renting, constructing and dismantling stands for trade fairs and exhibitions. In 1993 to 1995, Stadeco provided its services to the Economische Vorderlichtingsdienst (Press and Information Service of the Dutch Ministry of Economic Affairs, EVD) for trade fairs in Germany and countries outside the European Union, and charged to EVD on the related invoices a total amount of DFL 230,314 (EUR 104,512) in Dutch VAT. EVD, a body governed by public law, used the services solely for activities that were not subject to VAT and was not entitled to deduct the VAT. EVD paid Stadeco’s invoices and Stadeco remitted the VAT to the tax authorities.

In 1996, the Dutch tax authorities informed Stadeco that its services were deemed to be supplied for VAT purposes at the places where the trade fairs were held and, consequently, Stadeco was not liable to VAT in the Netherlands with regard to the services relating to trade fairs held abroad. Subsequently, Stadeco applied for a refund of the Dutch VAT that it had erroneously charged to EVD. The Dutch tax authorities made the refund subject to the condition that Stadeco issued a credit note. After Stadeco had presented a copy of the credit note to the tax authorities, the authorities refunded to Stadeco the total amount of EUR 104,512. However, during an audit in 2000, the tax authorities discovered that Stadeco had not issued the credit note to EVD. On that ground, the tax authorities reclaimed the amount of EUR 104,512 in VAT they had refunded to Stadeco, and charged it to EUR 13,090 in interest.

In the course of the subsequent proceedings, the Hoge Raad der Nederlanden (Supreme Court of the Netherlands) referred several questions on the interpretation of EU law in this scenario to the ECJ and, by its judgment of 18 June 2009, the ECJ declared, inter alia, that the principle of tax neutrality does not generally preclude Member States from making the refund of VAT, which was due in that Member State merely because it was erroneously mentioned on an invoice, subject to the requirement that the service provider has sent the recipient of the services a corrected invoice not mentioning that VAT, if the service provider has not completely eliminated, in sufficient time, the risk of loss of tax revenues.

In this respect, the ECJ first concluded that making the refund by the tax authorities of the VAT mentioned by Stadeco on its invoices, subject to the requirement that those invoices be corrected, does not in principle go beyond what is necessary to achieve the objective of completely eliminating all risk of loss of tax revenues. The ECJ then added that, in so far as the Dutch tax authorities also made the refund of VAT to Stadeco subject to the condition that Stadeco must repay the same amount to EVD, EU law does not prevent the Dutch tax authorities from disallowing the refund to Stadeco, where such refund would lead to unjust enrichment (of Stadeco). The existence and degree of unjust enrichment which refund of a tax (which was levied though not due under EU law) entails for Stadeco can be established only following an
analysis in which all the relevant circumstances are taken into account. It is for the national court to carry out such an analysis. In that context, the ECJ noted that it could be relevant whether the contracts concluded between Stadeco and EVD related to fixed amounts of remuneration for the services provided or basic amounts increased, where appropriate, by the tax applicable. In the first case, there might be no unjust enrichment of Stadeco, according to the ECJ.

4. Decision of National Court

Almost nine months after the ECJ delivered its judgment in Stadeco, the Hoge Raad der Nederlanden referred the case back to the Gerechtshof Amsterdam (Appeal Court) for final decision and, in that context, observed that the fact that the tax authorities are entitled to make the repayment of the VAT to Stadeco dependent on the issue of a credit note, which, according to the Hoge Raad, implies that Stadeco assumes the obligation to repay the initially charged VAT to EVD, does not necessarily mean that the credit note must concern the full amount of VAT Stadeco had previously charged to EVD. According to the Hoge Raad, it follows from the judgment of the ECJ (in Stadeco) that the power to demand correction of the initial invoice – in such a manner that Stadeco must repay the VAT to EVD – only exists if, in the absence of such a repayment to the final customer, Stadeco would be unjustly enriched.12

On 10 March 2011, the Gerechtshof Amsterdam gave what should have been the final decision,13 in which it only focused on the aspect of unjust enrichment. In this respect, the Gerechtshof selectively quoted two paragraphs derived from two previous judgments of the ECJ on unjust enrichment. The court observed that the ECJ has decided in Marks & Spencer plv. Commissioner of Customs and Excise, Case C-309/06, [2008] ECR I-2283.14

12. By linking the issue of the credit note to repayment by Stadeco of the Dutch VAT to EVD, the Hoge Raad der Nederlanden also linked the unjust-enrichment test to the issue of the credit note, not to repayment of the amount of VAT mistakenly refunded.
13. Decision of Gerechtshof Amsterdam of 10 March 2011 in Stadeco BV v. Staatssecretaris van Financien, Case 10/00162, LJN: BPI555. The decision of that court is, however, not the final decision because the tax authorities appealed against it.
15. Id, Para. 41.
16. Id, Para. 43.
18. Id, Para. 111.
20. All cases listed in note 19, with the exception of Roquette Frires and Marks & Spencer (see note 14), concerned repayment of taxes and charges that were imposed contrary to EU law. For example, Hans Just,Essevi & Spencer decided on excise duty on imported liquor at a higher effective rate than on domestically produced liquor, which was contrary to Art. 95 of the then EEC Treaty, San Giorgio concerned health inspec-

Although the principle of unjust enrichment is not a principle of EU law, the ECJ has already delivered a large number of judgments describing the terms and conditions under which Member States may refuse to repay indirect taxes to traders on the ground that they have already shifted the burden of the tax to a third party and would be unjustly enriched by receiving the tax from the tax authorities. However, unlike the case of Stadeco, those previous judgments concerned situations in which Member States had imposed unlawful taxes and charges, i.e. taxes and charges imposed in violation of primary EU law or higher-ranking national law.
6. Unlawful Taxes and Charges

It occasionally happens that EU Member States impose unlawful taxes and charges, i.e. imposition of those taxes and charges is prohibited under primary EU law, or Member States impose lawful taxes and charges in an unlawful (discriminatory) manner, which is also prohibited under primary EU law. After the ECJ has declared them to be unlawful, the taxes and charges can no longer be imposed. However, in addition, the imposition of those taxes and charges in the past must be reversed, albeit that, in the absence of EU rules on correction of the imposition of unlawful charges, repayment of the unlawfully collected taxes must be based on national rules for refunding taxes. Those refund rules are subject to EU principles in the sense that they must not be discriminatory and that restrictive conditions must not have the effect that refund of the unlawful tax or charge would become impossible or excessively difficult.

It is settled ECJ case law that individuals are entitled to obtain repayment of charges levied in a Member State in breach of provisions of EU law. The Member State in question is therefore in principle required to repay such unlawful charges. There is, however, one exception to that obligation: a Member State may only resist repayment to the trader of a charge levied, although not due, where the national authorities have established that the charge has been borne in its entirety by a third party and that repayment of the charge to the trader would constitute unjust enrichment of the latter. If the trader has passed on the burden of the tax or charge only in part, the national authorities are required to repay to the trader the amount not passed on.

Most indirect taxes are not separately recharged by traders to their customers. Therefore, the first step in establishing whether or not a refund of unlawfully imposed charges would unjustly enrich the trader who has remitted the charge to the authorities, is to establish to what extent the trader has actually shifted the burden of the charge to his customers. In this respect, the tax authorities may not rely on a legal presumption that the trader is deemed to have shifted, or is legally required to shift, the burden of the charge to his customers. However, even if the trader has fully incorporated the unlawful charge in his selling prices, the tax authorities may still have damaged the trader’s commercial position by imposing the unlawful charge because the increase in the price of the product brought about by passing on the unlawful charge may have led to a decrease in the trader’s sales. In such circumstances, the trader may justify claim that, although he had passed on the charge to his customers, inclusion of the unlawful charge in the cost price has, by increasing the price of the goods and reducing sales, caused him damage. Such damage excludes, in whole or in part, any unjust enrichment which would otherwise be caused by repayment by the tax authorities of the unlawful charge to the trader. The existence and degree of unjust enrichment which repayment of an unlawful charge entails for a trader can only be established on the basis of an economic analysis in which all the relevant circumstances are taken into account.

In its judgment in Weber’s Wine World,21 the ECJ has held that the burden of proving possible unjust enrichment of the party that seeks a refund of charges levied in a Member State in breach of EU provisions22 must be placed on the tax authorities.24

7. Unjust Enrichment Relating to Correction of Mistakes

It is objectively clear that the consequences of application of the principle of unjust enrichment depend on all the relevant circumstances and that the circumstances in Stadeco were different from those in which Member States imposed taxes in violation of EU law. In Stadeco, a service provider had charged Dutch VAT by mistake in a situation in which, according to the Dutch tax authorities, the services were subject to VAT in the countries where the related trade fairs were held (in Germany).25 It is also clear that the Dutch tax authorities were not in any way responsible for Stadeco’s mistake, which means that the tax authorities cannot be held responsible for any loss of turnover that may have resulted from the fact that Stadeco had charged Dutch VAT to EVD. In this context, it should be noted that, in its judgment in Stadeco, the ECJ observed that the existence and degree of unjust
Unjust Enrichment under EU VAT

enhancement which refund of the Dutch VAT would entail for Stadeco can be established only following an analysis (not an economic analysis) of all relevant circumstances.

As the ECJ expressly observed in its judgment, Stadeco would not be unjustly enriched by repayment of the Dutch VAT, if the contracts concluded between Stadeco and EVD related to fixed amounts of remuneration for the services. This observation obviously means that Stadeco would not be unjustly enriched by receiving a refund of the Dutch VAT if it had remitted German VAT out of the fixed VAT-inclusive price. For example, if Stadeco had charged to EVD a fixed price for its services of, say, 119, including 19\% VAT, the service provider would obviously not be unjustly enriched if, instead of remitting 19\% Dutch VAT, Stadeco had remitted a similar amount in VAT in Germany in or the countries outside the European Union.

Alternatively, Stadeco would also not be unjustly enriched by receiving a refund of the Dutch VAT if the fact that its services were "not subject to VAT" would mean that they were "exempt" from VAT and, consequently, Stadeco would have lost its right to deduct related input tax. Under the latter circumstances, it would not be fair to require Stadeco to repay the full amount of the initially charged Dutch VAT to EVD. However, Stadeco’s services were not exempt from VAT, neither in the Netherlands nor in Germany under EU law. Even if the services were exempt in the non-EU countries where the trade fairs actually took place, Stadeco would still be entitled to deduct related input tax in the Netherlands. In this case, a large part of Stadeco’s services were deemed to be supplied in Germany and, consequently, Stadeco should at least have accounted for VAT in that Member State. The offer of the Dutch tax authorities to refund to Stadeco the Dutch VAT to the extent that Stadeco had paid VAT in Germany in respect of the services provided there should have been more than enough to compensate Stadeco for any possible adverse consequence of its own mistake.

The confusing aspect of the ECJ’s judgment in Stadeco was that the ECJ made allowance for a situation that was not relevant in that case: Stadeco has never remitted the VAT due in Germany or elsewhere.

8. Repayment of VAT to Final Customer

By its judgment in Reemtsma, the ECJ decided that the principles of neutrality, effectiveness and non-discrimination do not preclude national legislation, under which only the trader may seek reimbursement by the tax authorities of the sums unduly paid as VAT, and under which the recipient of the supply may start a civil law action against that trader for recovery of the sums paid but not due. However, where reimbursement of the VAT would become impossible or excessively difficult, Member States must provide for the instruments necessary to enable the recipient of the services to recover the unduly invoiced tax, in order to respect the principle of effectiveness.

As one of the circumstances under which it becomes impossible for the customer to seek from his supplier repayment of the VAT he has unduly paid to the supplier, the ECJ mentioned in particular the case of the supplier’s insolvency. However, seeking repayment of the unduly paid VAT may also have become impossible for the customer, if the supplier (Stadeco) simply refuses to repay the VAT to his customer and, by the time the dust has settled in the tax proceedings (Stadeco rendered the services to EVD in the years 1993 to 1995, i.e. 18 years ago), a civil law action by the customer against the supplier has become time barred. Consequently, if Stadeco were allowed to keep the VAT and if it continued to refuse to repay it to EVD (which can reasonably be assumed to be the case), the tax authorities may also be confronted with a claim by EVD for repayment of unduly paid VAT, even though they have already repaid it to Stadeco. It may be impossible or at least excessively difficult for EVD to exercise its claim on Stadeco. Besides, recovery of unlawfully imposed taxes and charges, by the person who has borne the burden of the tax or charge from the supplier in a civil law claim, may be excessively difficult if the parties had agreed on a total VAT-inclusive price. Also, the recovery procedure under civil law may be more burdensome than recovery of the unlawful tax from the tax authorities. Depending on the judgment that the ECJ is to deliver in Danfoss, the question may arise whether it is acceptable that the procedure for recovery of unlawful taxes for the final customer...
is more burdensome than for the trader, who remitted it to the tax authorities. Should the ECJ declare that it is not acceptable that the recovery procedure for the final cus-
tomer is more burdensome than for the trader, the next question is whether the same principle also applies to re-
covery of VAT charged to the final customer by mistake.

9. Conclusions
By its judgment in Stadeco, the ECJ confirmed that taxable persons can escape from the liability to remit VAT mentioned by mistake on an invoice by correcting the invoice, even if it can generally be assumed that the customer is not entitled to deduct the VAT. Correction of the invoice does not in principle go beyond what is necessary to achieve the objective of completely eliminating all risk of loss of tax revenue. In that respect, the ECJ’s position is very plausible because correction of incorrect invoices is in line with normal commercial practice. Correction of an invoice means that the supplier credits his customer for the tax that appears not to be due and, at the same time, debits him for the tax that is actually due. If the taxable person has already remitted the erroneously charged VAT to the tax authorities, the latter must refund it to the taxable person who made the mistake, unless the taxable person would be unjustly enriched. In this respect, the unjust-enrichment test is much simpler than in cases in which the tax authorities imposed a tax contrary to EU law. If the VAT charged to the customer is not due on account of a mistake made by the supplier, it is unnecessary to analyse to what extent the supplier has shifted the burden of the tax to a third party (his customer) or to what extent the supplier has damaged his own competitive position by charging too much VAT.

It is amazing that, in the framework of deciding on an application for refund of VAT by a trader who has mentioned it on an invoice by mistake, a national court simply cuts and pastes conclusions derived from ECJ judgments relating to totally different scenarios.

It is also amazing that, in the framework of Stadeco’s refund application, the Dutch tax authorities have accepted Stadeco’s credit note for the full amount of Dutch VAT. It is clear that, to a large extent, the Dutch VAT on the initial invoices should have been replaced by German VAT and that Stadeco should have remitted the German VAT to the German tax authorities. Many difficulties could have been prevented if, when they informed Stadeco in 1996 that a large part of its services were deemed to be supplied for VAT purposes in Germany, the Dutch tax authorities had also informed their German colleagues of the fact that Stadeco rendered services that were subject to German VAT.34

Finally, it is amazing that a national Supreme Court strings together two separate conditions mentioned by the ECJ and applies restrictions applicable to the second condition also to the first condition (see 4.).

Since Stadeco failed to register in Germany and has not accounted for the VAT due there, nor incurred any non-deductible input tax in the framework of its activities, it is obvious that the company would be unjustly enriched if it were allowed to keep any part of the Dutch VAT. This conclusion has nothing to do with the fact that the company in question acted in a deceitful and fraudulent manner.

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34 Due to the amendment of the place-of-supply rules with effect from 1 January 2011, Stadeco will no longer be required to register for VAT in other Member States (Germany) in respect of services supplied to regis-
tered customers. From that date, the services are deemed to be supplied at the place where the customer is established and, where the service provider and customer are not established in the same Member State, the customer must account for VAT under the reverse charge mechanism. In respect of services supplied to non-registered customers, the former place-of-supply rule continues to apply, i.e. Stadeco will have to charge German VAT if its services relate to a fair or exhibition that takes place in Germany.
When GST was introduced in Australia, it was supposed to be simpler than the wholesale sales tax it replaced. However, almost 11 years after the introduction of the simpler tax, there are still areas in the GST system that lack clarity, for example the issue of how much vacant land should be regarded as “residential premises” for GST purposes. In this article, the author discusses the background of this issue and various options to resolve the problem.

1. Introduction
When GST was introduced in Australia more than a decade ago, it was supposed to be simpler than the wholesale sales tax it replaced. In its White Paper, the government indicated that a flaw of the previous tax system was that supplies of goods could be exempt from tax “or taxed at one of six different rates”. The government stated that “[m]ultiple rates can lead to confusion... Consumers almost never know how much tax they pay on goods”, and it advocated a system “that is less complex”. However, almost 11 years after the introduction of the simpler tax, there are still areas in the GST system that lack clarity, for example the issue of how much vacant land should be regarded as “residential premises” for GST purposes.

2. Supplies of Residential Premises
The GST Act contains rules for taxation of “consumption” of three categories of residential premises:
– commercial residential premises, i.e. premises destined to be let for residential use, such as hotels;
– new residential premises; and
– used residential premises.

Supplies of commercial residential premises and new residential premises are subject to GST if the supplies are made by a registered entity in the course or furtherance of an enterprise. However, supplies of used residential premises are generally regarded as being exempt from GST (or, in Australian terminology, as “input-taxed” supplies). The GST that is due on the first supply of newly constructed residential premises is presumed to be an advance payment of the present value of the total amount of GST due on future use of the premises and, since residential premises are generally “consumed” over a long period of time, this presumption prevents determination of the amount of GST homeowners must periodically pay on their use of residential premises.

The GST Act contains rules to determine whether premises are residential (and therefore the supply of the premises is input taxed if the building has been occupied before) or commercial (subject to GST). However, the Act does not explicitly define the circumstances under which land must be regarded as input taxed or subject to GST and, after more than ten years of GST, it is still not clear whether homeowners must pay GST on the purchase of vacant land that is supplied in combination with a residential building and, if the transaction is subject to GST, how much GST is due.

There appear to be clear policy reasons to treat residential land in the same way as residential buildings. People often use small plots of land surrounding their residential buildings for residential purposes, for example as a driveway, for a letterbox or clothes lines, as a garden, etc. Taxing land that is clearly used in connection with input-taxed residential buildings would be unfair and inconsistent with the principle of treating supplies of used residential buildings as input-taxed supplies. It would also be inconsistent with English law, from which Australian law has developed. In English law, the word “curtilage” has been used for hundreds of years and encompasses land that is used as part of a residential home, such as the driveway and garden. If that word were to have been used in connection with the supply of residential premises under Australia’s GST, the expression “residential premises” would be interpreted as covering the building that a person lives in, as well as the land adjoining the home and used in connection with it. However, whilst tax collectors existed even before the days of Robin Hood, and continue to exist, the word “curtilage” has not been transposed into the Australian GST legislation.

The main area of uncertainty concerns large plots of land on which also a residential building is located. In the outskirts of metropolitan cities, homes are often built on large plots of land that are perhaps smaller than what we might call a “farm”, but large enough for a non-urban lifestyle. There is an obvious rationale for limiting the area of land that can be regarded as forming part of an input-taxed supply in such situations. Treating all supplies of vacant land as input-taxed supplies would narrow the tax...
Evidence of the uncertainty surrounding the GST treatment of vacant land was highlighted in a recent civil case concerning an alleged misrepresentation by an estate agent that there would be no GST payable on the sale of vacant land. In Williams v. Macsfield, the Tribunal decided that the real estate agent was not liable for misrepresentation, as the Tribunal found that the agent’s negative answer to the purchaser’s question of whether the supply of residential premises was fully subject to GST did not cause the purchaser to enter into the contract. However, in other situations, agents could be found liable if the lack of clarity is not resolved.

3.2. Alternative approaches

There may be lessons to be learned from other tax laws. In other tax laws relating to the supply of land, there are two approaches to determine how much land should be regarded as residential premises and, on that ground, be exempt from tax:

- a particular quantity of land is defined to be exempt from tax; or

8. The Australian approach of only treating a supply of land as input taxed if it is the supply of vacant land used in connection with a residential building is different from the situation in the European Union where, by virtue of Art. 135(1)(j) and (k) of the VAT Directive, not only the land on which a building stands is exempt from VAT (if the supply of the building is also exempt), but also land which has not been built on is exempt from VAT. In Australia, there was a concern that the approach taken in the European Union would narrow the tax base too much and, therefore, supplies of ‘undeveloped’ land, i.e. land that has not been built on and that is not destined as ‘building land’, are subject to GST by implication, unless the land is Crown land.

9. In Australia, public land is considered to belong to the Crown. Crown land includes land for nature conservation and various other governmental purposes, as well as some vacant land. Crown land is held in the “right of the Crown” of either an individual state, territory or the Commonwealth of Australia; there is not a single “Crown” (as a legal governmental entity) in Australia. Various states have adopted differing policies towards the sale and use of their Crown lands. Crown land is used for, for example, airports (Commonwealth) and public utilities (usually state).

10. The focus of this article is the GST treatment of land that is intended to be used for private purposes. The GST treatment of farmland, transfers of a business as a going concern and Crown land is therefore outside the scope of this article. In brief, supplies of farm land are GST free under Sec. 38-480 of the GST Act if both the land was used for a farming business for at least five years immediately before the sale, and the buyer intends to use it for a farming business. Transfers of businesses as going concerns are treated as GST free if the transferor provides the transferee with all of the things that are necessary for the continued operation of the enterprise and the transferor carries on the enterprise until the day of the transfer (Sec. 38-325). The GST treatment of supplies of Crown land is laid down by Sec. 38-445 of the GST Act.

11. Capital gains tax in Australia is not a separate tax, but a component of income tax.


13. Similarly, in the framework of the proceedings in Vidler v. Federal Commissioner of Taxation, in which the Administrative Appeals Tribunal delivered its decision on 1 June 2009, [2009] AATA 395, the Commissioner of Taxation submitted that “vacant land . . . can never be “capable of being occupied” as a residence or for residential accommodation at the time of its supply”; see para. 28 of the decision.

14. In para. 25 of GST Ruling 2000/20, the ATO has indicated that the definition of residential premises “requires that land must have a building affixed to it.” In GST Ruling 2003/3, the Commissioner came to a similar conclusion at para. 26. The documents are available on the ATO’s website, http://law.ato.gov.au.

3.2.1. Particular quantities of land

Canada’s principal GST exemption for the sale between certain parties of a “residential complex” applies to the actual dwelling, as well as the “messuage”. The term “messuage” is defined in the Canadian GST legislation as meaning the additional land surrounding the dwelling and used and occupied with it, of up to half a hectare.

In this context, it is also relevant to discuss the income tax provisions under which residential land is exempt from capital gains tax, as it is good policy to exempt, both for GST and income tax purposes, residential land from taxation in order to simplify tax administration and encourage people to purchase their own homes.

In Australia, a capital gain relating to a “dwelling” that serves as a taxpayer’s main residence is exempt from income tax. This exemption extends to land that is adjacent to a dwelling of up to two hectares, to the extent that the taxpayer uses the land primarily for private or domestic purposes in association with the dwelling. In the absence of that restriction, the entire surrounding land would be part of the residence property.

In order to determine what land can be regarded as exempt from income tax in Canada, a half-a-hectare rule applies. The principal residence of a taxpayer is described to include:

the land subjacent to the housing unit and such portion of any immediately contiguous land as can reasonably be regarded as contributing to the use and enjoyment of the housing unit as a residence, except that where the total area of the subjacent land and of that portion exceeds half a hectare, the excess shall be deemed not to have contributed to the use and enjoyment of the housing unit as a residence unless the taxpayer establishes that it was necessary for such use and enjoyment.

In the United Kingdom, an individual is entitled to relief from capital gains tax if disposing of land that constitutes a garden or grounds, usually of up to half a hectare, which is enclosed and surrounding, or attached to, a residential building, and which serves “chiefly for ornament or recreation”.

Similarly excluded from income tax in New Zealand is the sale of land of up to 4,500 m² with a residential building on it, or more land if a larger area is required for the reasonable occupation and enjoyment of the residential building.

3.2.2. Curtailage

A second approach that has been taken to determine how much land should be regarded as forming part of residential premises is to use the word “curtilage” or a similar word to denote small pieces of land used and enjoyed with the home that can be regarded as exempt from GST, if supplied together with the home.

Whilst the English Court of Appeal interpreted the word “curtilage” in 1979 as meaning the plot of ground attached to a dwelling and forming an enclosure with it, the word “appurtenance”, which is regarded as forming part of a “dwelling” for GST purposes in New Zealand has recently been interpreted more widely. In relation to apartments in a retirement village, the New Zealand Court of Appeal has stated that “[t]he common areas and the facilities upon them, the use and enjoyment of which is promised to the residents of the dwellings... are appurtenances of the dwellings.”

Arguably, New Zealand courts may have gone too far in interpreting the concept of a dwelling. In Case R17, the New Zealand Taxation Review Authority (TRA) came to a rather surprising result when it decided that the whole area of a farm, used partly for residential purposes, but mainly as a dairy farm, was to be regarded as an exempt.
supply of a dwelling. However, in another case, the TRA expressed a word of caution that the definition of a dwelling in New Zealand “would normally apply only to the land upon which the dwelling stood and, perhaps, the land immediately adjacent thereto... It would not... include necessarily the whole of the allotment on which the dwelling was erected.”

3.3. Preferred approach

The approach discussed in 3.2.2. of indicating that vacant land can form part of an input-taxed (exempt) supply of residential premises, but leaving it to the courts to decide how much land forms part of the residential building, produces uncertainty. That approach leaves taxpayers unsure of how much land can be regarded as being exempt from tax, and opens the door to litigation. However, a criticism of the approach of indicating that a specific maximum amount of land will normally be regarded as forming part of the supply of a residential building (see 3.2.1.), is that it may be too restrictive. Fixed criteria may become outdated as the circumstances change. However, when it comes to land, this criticism is weak, as the size of residential plots of land generally reduces over time (see below). When it comes to vacant land, the preferred approach is therefore to adopt specific statutory rules referring to a measurement as guidance. If this sort of approach were to be used in Australia for GST purposes, it would give more certainty. It would also result in less of an administrative burden on the tax administration to decide how much land should be regarded as residential premises in individual cases.

Application of fixed criteria gives rise to the question of at what level the criteria must be set. As explained in 3.2.1., the maximum amount of residential land for GST and income tax purposes in Canada and for income tax purposes in the United Kingdom is half a hectare, unless it can be shown in Canada that more land is reasonably necessary for the use and enjoyment of the building as a place of residence for individuals. Income tax legislation in New Zealand makes, in this context, reference to 4,500 m², which is a similar amount of land. By contrast, Australian income tax legislation makes reference to two hectares.

Research conducted by the Australian Bureau of Statistics indicates that, in 200304, the average site area of a new house in Australia was 735 m², which is 67 m² less than 11 years earlier. This area is equal to 0.0735 hectares, which is substantially less than the two-hectare threshold for capital gains tax purposes. Two hectares would appear to open the door too wide. Reference to a different measurement is required. The measurement that has been used in jurisdictions with similar tax systems, where a criterion of about half a hectare is generally used, would appear more appropriate. In Australia, it is becoming more common for development to push out of metropolitan areas and for farmland around country towns to be subdivided. Owners of residential properties in these areas may live on larger plots of land than what is common in the cities; the indicative measurement should still allow such owners to claim that the land on which they live is residential.

In the exceptional situation where a person lives on a large plot of land used partly for residential purposes and partly for other purposes, then the price paid for the property will need to be split. Only the part of the land which is used for residential purposes should be input taxed. In such a situation, the preferred approach will give guidance as to how much of the land should be regarded as input taxed.

4. Conclusion

There has been a lack of certainty about how much land can be regarded as forming part of residential premises for GST purposes in Australia. However, it is logical for land used and enjoyed with a residential building to form part of the residential premises and to be regarded as being input taxed for GST. Looking at the approaches that have been taken to characterize land in Australia, as well as in other countries, it is suggested that the GST legislation in Australia should be amended to make it clear that half a hectare of land used and enjoyed with a residential building will usually be regarded as forming part of the residential premises, unless it is proven on a case-by-case basis that a larger area of land is required for such use and enjoyment.

28. The New Zealand Taxation Review Authority (TRA) is a statutory body appointed to hear and make judgment on cases where someone objects to a tax assessment or a decision by the Inland Revenue Commissioner. The TRA can hear disputes regarding any amount of tax. It can also hear cases where the legal issues affect unrelated disputes between Inland Revenue and other taxpayers. The TRA currently consists of a District Court Judge and receives administrative support from the Ministry of Justice. The TRA is a tribunal that forms part of New Zealand’s judicial system.


31. Half a hectare is 5,000 m².

Armenia

Outstanding VAT liabilities

On 2 May 2011, the government submitted to the National Assembly a draft law introducing support measures for companies and individual entrepreneurs with outstanding tax liabilities, including VAT liabilities.

Under the proposal, taxpayers with outstanding tax liabilities, which arose before 1 January 2010, are able to enter into an agreement with the tax authorities and set up a payment schedule before 20 August 2011, as follows.

If the tax debt, including interest and penalties:
- is less than AMD 50 million, the tax debt must be paid off between 1 September 2011 and 30 June 2012, and each monthly payment must at least be \( \frac{1}{10} \) of that debt; and
- is equal to or higher than AMD 50 million, the tax debt must be paid off between 1 September 2011 and 31 July 2013, and each monthly payment must at least be \( \frac{1}{52} \) of that debt.

Taxpayers who pay off the outstanding tax debt in a timely manner, i.e. in accordance with the agreed payment schedule, are relieved of payment of interest and penalties.

If the taxpayer fails to comply with the agreed payment schedule, the tax authorities will bring their claim before a court.

Austria

On 31 May 2011, the Ministry of Finance amended its proposal\(^1\) for amendment of the VAT Act, the “Abgabenänderungsgesetz 2011”, which contained the following changes in comparison with the initial proposal.

Reverse charge mechanism

The Ministry of Finance withdrew its initial proposal to extend the reverse charge mechanism to all supplies of goods made by suppliers who do not have their seat in Austria or a fixed establishment there that intervenes in the supply.

Extension of the reverse charge mechanism to supplies of mobile telephones and integrated circuit devices, such as microprocessors and central processing units, for which the taxable amount is equal to or higher than EUR 5,000 will take effect on 1 January 2012, not on 1 July 2011, as initially proposed.

Admission to events

The Ministry of Finance maintained its initial proposal to abolish, with effect from 1 January 2012, the reverse charge mechanism in respect of admission to cultural, artistic, sporting, scientific, educational, entertainment or similar events, such as fairs and exhibitions, and of ancillary services related to the admission. However, the Ministry further clarified its proposal by adding that those services will also be excluded from the application of the special withholding scheme laid down by Sec. 27(4) of the VAT Act. Under the withholding scheme, non-resident suppliers must charge the VAT due in Austria to their customers and, instead of paying the VAT to their supplier, the customers must withhold it and remit it to the tax authorities in the name and on behalf of the non-resident supplier.

Consequently, taxable persons that supply those services in Austria and do not have their seat or a fixed establishment there must register for VAT purposes and themselves remit the VAT due on the services to the tax authorities.

Reduced rate

Following the ECJ’s judgement in the infringement procedure of the European Commission against Austria,\(^2\) the scope of the reduced VAT rate of 10% will be limited, with effect from 1 January 2012, to the supply, importation and intra-Community acquisition of certain live animals, in particular horses, intended for use in the preparation of foodstuffs for human or animal consumption.

From our correspondent Hannes Gurtner
Leitner+Leitner, Linz

Belgium

Postal services

Under the law of 5 April 2011, which was published in the Official Gazette of 21 April 2011, the exemption for postal services laid down by Art. 44(3)(14) of the VAT Code was limited to services, and supplies of goods ancillary thereto, rendered by providers of universal postal services, provided that their services also form part of the universal postal services, as defined in Art. 142 of the Law of 21 March 1991 on the reform of some economic government companies. This amendment will come into effect on 1 January 2012, unless the date of entry into force is set by Decree at an earlier date.

Fixed establishments

Under Art. 21(2) of the VAT Code, services are generally deemed to be supplied to taxable persons at the place where the customer has established the seat of its economic activity or a fixed establishment. In the latter case, the fixed establishment is a taxable person’s presence abroad, characterized by a sufficient degree of permanence and a suitable structure, in terms of human and technical resources, to enable it to receive and use the services supplied to it for its own needs. Services supplied to non-taxable persons are generally deemed to be supplied at the place where the service provider has established the seat of its economic activity or a fixed establishment. In

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\(^{2}\) ECJ judgment of 12 May 2011 in European Commission v. Republic of Austria, Case C-441/09, see ECJ VAT Cases in this issue.
the latter case, the fixed establishment is a taxable person’s presence abroad, characterized by a sufficient degree of permanence and a suitable structure, in terms of human and technical resources, to enable it to provide the services it supplies.3

In response to parliamentary questions, the Minister for Finance indicated that an information centre in Belgium that forms part of a company established abroad seems to qualify as a fixed establishment if the staff employed at the information centre take orders for goods that are to be supplied by the non-resident company and will be delivered from abroad directly to the customers in Belgium, even if the staff of the information centre are not authorized to conclude contracts binding the non-resident company in any way.4


**Provision of immovable property**

Art. 44(3)(2°)(a) of the VAT Code provides for an exemption from VAT for the letting and leasing, and for the supply, of goods that are immovable by nature, with the exception of, inter alia, the letting and leasing (“provision”) of goods that are immovable by nature in the framework of the operation of ports, navigable waterways and airports. The latter transactions are subject to VAT, regardless of whether or not the supplier also operates the (air)port or waterway, and regardless of whether the supplier belongs to the private or public sector.

Chamber, Verbal question, Committee for Finance and the Budget, 11 May 2011, Beknopt Verslag, COM 229, 22.

From our correspondent Patrick Wille

The VAT House, Brussels

**Non-resident building contractors**

In a press release of 16 June 2011, the government announced that the Council of Ministers has approved a proposal for various legislative changes.

As regards VAT, the government proposes to abolish the requirement that, in order to benefit from the reduced VAT rate for construction work, non-resident building contractors must be registered for income tax in Belgium. This change follows the withdrawal of the question referred to the ECJ by the Rechtbank van eerste aanleg (Tribunal of first instance) Brussels in Knubben Dak- en Leidekkersbedrijf of whether the limitation of the field of application of the reduced VAT rate to construction work undertaken by registered contractors is compatible with the fundamental freedom to provide services.

**Infringement procedure – Buildings**

On 6 April 2011, the European Commission announced that it has closed an infringement procedure against Belgium concerning the application of a reduced VAT rate to certain transactions involving buildings.6 The Commission decided to close the procedure after Belgium had amended its legislation.

European Union’s website.

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3. See Para. 16 of Notice AFZ No. 19/2009 of 22 December 2009
4. Further criteria for determining whether a non-resident company’s presence in Belgium is able to receive and use services for its own needs are laid down by Para. 17 of Notice No. 19/2009 (see note 3).
7. Private rulings issued by the COSIT reflect the official position of the Federal Revenue Office and must be followed by regional tax offices. Private rulings are binding only on the taxpayer who has requested the ruling, but may serve as a precedent to other taxpayers who are in a similar situation.
8. PIS/PASEP (Contribuição para o programa de integração social e para o programa de formação de patrimônio do servidor público) and COFINS (Contribuição para o financiamento da seguridade social) are federal social contributions levied at the rates of 1.65% and 7.6%, respectively, on the total turnover of legal entities, with the exception of turnover derived from practically all financial services, and the value of imported goods. Under the non-cumulative system, entities subject to those contributions are entitled to deduct an amount corresponding to the PIS/PASEP and COFINS levied at the preceding stage on certain goods and services used for the purposes of their business. IPI (Imposto sobre produtos industrializados), is a federal tax levied at the rate of 0% to 36.5% on the supply and importation of manufactured products, in principle, input IPI is deductible from IPI due.
Nigre
Supplies of edible vegetable oils and agricultural products are subject to VAT at the reduced rate of 13%. Under SAT Public Notice [2011] No. 20, nigre (Chinese honey locust fruit) does not qualify as an edible vegetable oil or as an agricultural product, which means that the supply of that product is subject to the standard rate of 17%.

Combinations of goods and services
Under Art. 6 of the VAT Implementing Rules and Art. 7 of the Business Tax Implementing Rules, businesses that supply self-produced goods in combination with construction services must separately account for VAT on the value of the supplied goods, and for business tax on the value of the construction services. If the supplier cannot distinguish the values of the two components, the tax authorities will split up the total price under SAT Public Notice [2011] No. 23. To that end, the supplier must provide documentary evidence to the tax authorities competent for the place where the construction services are provided, showing that he is also engaged in the production of the goods. The evidence must be authenticated by the tax authorities competent for the place where the supplier is established. The tax authorities competent for the place where the construction services are provided calculate and collect business tax in accordance with the documentary evidence provided by the supplier.

Processing of corn
In order to curb over-fast development of the sector of corn processing, businesses that purchased corn from agricultural producers for further processing the goods for purposes other than producing animal feed were temporarily (from 20 April 2011 to 30 June 2011) not entitled to deduct VAT on the purchase of corn, under Caishui [2011] No. 34, which was issued with the approval of the State Council.

From our correspondent Xiaoqiang Yang
Sun Yat-Sen University School of Law, Guangzhou

Czech Republic

Single VAT rate
On 25 May 2011, the government proposed merging the current standard rate of 20% and the reduced rate of 10% into a single rate of 17%, with effect from 1 January 2013. To become law, the proposal must be adopted by the parliament and signed by the president.

European Union

Modernized EU VAT
On 29 June 2011, the European Commission published questions and answers on the Multiannual Financial Framework (MFF), which translates the European Union’s political priorities for at least five years into financial terms. Under Art. 312 of the Treaty of Lisbon, the MFF is laid down in a Regulation to be adopted unanimously by the Council after obtaining the consent of the European Parliament.

The next MFF will present the budgetary priorities of the European Union for the years 2014 to 2020. In this context, the Commission proposed to end the VAT-based own resource from 2014 and to introduce two new own resources: a tax on financial transactions and a “modernized VAT”. The proposed modernized VAT would create a genuine link between national and EU VAT, and foster additional harmonization of national VAT systems. It would provide significant and stable receipts to the European Union with limited administrative and compliance costs for national administrations and businesses. The modernized VAT forms part of a broader initiative launched by the Commission in December 2010 with the issuance of the Green Paper on the future of VAT aimed at reducing the extent of tax-induced distortions in the internal market.

MEMO/11/468 of 29 June 2011.

Council Decision – Registration threshold – Lithuania
See under Lithuania.

Council Decision – Reverse charge mechanism – Romania
See under Romania.

Infringement procedure – Buildings – Belgium
See under Belgium.

Infringement procedure – Open-end leases of passenger vehicles – Hungary
See under Hungary.

Infringement procedure – Ships – Italy
See under Italy.

Infringement procedure – Travel agents – Netherlands
See under Netherlands.

Infringement procedure – Medical items – Spain
See under Spain.

Administrative cooperation – Competent authorities
On 3 March 2011, the European Commission published the list of competent authorities referred to in Art. 3 of Council Regulation No. 904/2010 (administrative cooperation and combating fraud in the field of VAT) (re-cast), i.e. the authorities in whose name Regulation No. 904/2010 is to be applied, whether directly or by delegation.


**False VAT identification numbers**

On 30 May 2011, the European Commission published a warning that only tax administrations can issue VAT identification numbers.

The European Commission has been informed that companies in various Member States have received an offer for a valid VAT identification number against payment. These offers have the appearance of official EU documents.

The Commission recommends that taxable persons contact the local tax authorities if they are suspicious of unsolicited messages concerning new VAT identification numbers.

In addition, the Commission brought to the attention of taxable persons the list of thresholds, VAT identification numbers, the format of VAT identification numbers and abbreviations.

European Union’s website.

**Services connected with immovable property**

Art. 47 of the VAT Directive provides that services connected with immovable property are deemed to be supplied at the place where the immovable property is located. Those services expressly include:

- the services of experts and estate agents;
- the provision of accommodation in the hotel sector or in sectors with a similar function, such as holiday camps or sites developed for use as camping sites;
- the granting of rights to use immovable property; and
- services for the preparation and coordination of construction work, such as the services of architects and of firms providing onsite supervision.

In view of an increasing number of questions on the scope of that provision, the European Commission has drawn up a comprehensive document on that topic. The Commission’s position can be summarized on the basis of its first proposal to the VAT Committee for the following guideline (specific elements of the Commission’s proposal are directly derived from the text of Art. 47 or based on guidelines adopted by the VAT Committee in the past).

The VAT Committee unanimously agrees that, for the purposes of the VAT Directive, immovable property shall be any specific part of the earth’s surface, including the buildings constructed thereon and any items making up part of a building which cannot be moved without destroying or altering the building over which title and possession can be created unless such title and possession is excluded under the rules of international public law.

The VAT Committee unanimously notes that only transactions qualifying as supplies of services shall fall under Art. 47 of the VAT Directive. Where the handing over of construction work is regarded as a supply of goods, Art. 47 shall therefore not apply.

For services connected with immovable property to be covered by Art. 47 of the VAT Directive, the VAT Committee is of the unanimous view that the connection with the property shall be sufficiently direct. To be regarded as sufficiently direct, the property shall be the direct object of the service supplied or it shall make up a constituent element and be central and essential for the services supplied.

The VAT Committee unanimously considers that services provided to, or directed towards, an immovable property having as their object the legal or physical alteration of that property, shall be regarded as directly connected with immovable property.

The following services, in particular, shall be covered by Art. 47:

1. the drawing up of plans for a building or parts of a building designated for a particular plot of land regardless of whether the building is erected;
2. the provision of onsite supervision;
3. construction work performed on a building or parts of a building or on land;
4. renovation and repair of a building or parts of a building, including work such as tiling, papering and parqueting;
5. the installation or assembly of equipment which, upon installation or assembly, becomes part of an immovable property;
6. the repair and maintenance, inspection and supervision of equipment if the equipment is part of an immovable property;
7. the valuation of immovable property, including where such service is needed for insurance purposes, to determine the value of a property as collateral for a loan or to assess risk and damages in disputes;
8. intermediation in the sale or letting of immovable property;
9. the granting of rights to use immovable property;
10. the services of experts and estate agents;
11. the services of architects and of firms providing onsite supervision.

11. In its 60th meeting, the VAT Committee adopted the following guideline: All delegations unanimously agreed that, for tiling, papering and parqueting, the place of supply is where the immovable property is situated. Some Member States reach this conclusion because they consider these operations as a supply of a service, to be taxed in accordance with the provisions of Art. 9(2)(a) of the [former] Sixth Directive [which corresponds with Art. 47 of the current VAT Directive] at the place where the immovable property is situated. However, other Member States make use of the option provided for under Art. 5(3) of the [former] Sixth Directive [which corresponds with Art. 14(3) of the current VAT Directive], and consider these operations to be supplies of goods. In this case, some Member States consider these operations to be supplies of goods with installation or assembly by or on behalf of the supplier, falling within the scope of Art. 8(1)(a) of the [former] Sixth Directive [which corresponds with Art. 36 of the current VAT Directive], while other Member States consider this to be a supply of goods that takes place at the time the work is finished and therefore falling within the scope of Art. 8(1)(b) of the [former] Sixth Directive. For intra-Community operations, the differences in the Member States’ interpretations (supply of goods or supply of services) lead to differences regarding the obligation to submit the recapitulative statement provided for in Art. 22(6) [of the former Sixth Directive, which corresponds with Arts. 262 to 271 of the current VAT Directive].

All delegations unanimously agreed that the supply of a good whereby the supplier also carries out certain services, such as the plugging in of a machine or connecting a water pipe to an existing tap and the drainagepipe to the outlet, should be considered one single supply of a good without instal-lation or assembly and that these accessory services should be considered as activities of minor importance. This remains, nevertheless, an analysis on an ad hoc basis, case by case.

12. Art. 34 of Implementing Regulation 282/2011, which corresponds with Art. 5 of Implementing Regulation 1777/2005, provides that, except where the goods being assembled become part of immovable property, the place of supply of services to a non-taxable person consisting of the assembling and constructing of a machine or of an item which is part of a building, falls under Art. 16 of the VAT Directive. Where the handing over of construction work is regarded as a supply of goods, Art. 47 shall therefore not apply.

For services connected with immovable property to be covered by Art. 47 of the VAT Directive, the VAT Committee is of the unanimous view that the connection with the property shall be sufficiently direct. To be regarded as sufficiently direct, the property shall be the direct object of the service supplied or it shall make up a constituent element and be central and essential for the services supplied.

13. In its 16th meeting, the VAT Committee adopted the following guideline: In the specific case of an owner of a holiday home situated in Member State A who lets it to a travel agent in Member State B, with the agent acting as intermediary and receiving his commission from the owner, the overwhelming majority of the Committee considered that, as VAT law stands at present, Art. 9(2)(a) [of the former Sixth Directive, which corresponds with Art. 47 of the current VAT Directive] must apply. The Committee also agreed to determine the scope of Art. 26 [of the former Sixth Directive, which corresponds with Arts. 306 to 310 of the current VAT Directive] and of associated problems which might follow in connection with Art. 9 [of the former Sixth Directive], and, if necessary, to re-examine the situation.

In its 23rd meeting, the VAT Committee adopted the following guideline: (1) The delegations agreed unanimously that a travel agency, insofar as it directly supplies its services by its own means, is no longer acting as an
agency (Art. 26 [of the former Sixth Directive, which corresponds with Arts. 306 to 310 of the current VAT Directive]) but is carrying out an economic activity which is subject to the general principles of the [former] Sixth Directive. Each operation would be taxed entirely, or exempted entirely, in the Member State in which the activity was carried out. If the above conditions are met, the operations connected with the provision of camping facilities [...] would be subject to the provisions of Art. 92(2)(a) [of the former Sixth Directive, which corresponds with Art. 47 of the current VAT Directive].

2. [3-] [...]

4. In its 83rd meeting, the VAT Committee adopted the following guideline: The great majority of delegations agreed that legal services referring to immovable property shall only be considered as connected with immovable property within the meaning of Art. 45 of the VAT Directive [which corresponds with Art. 47 of the current VAT Directive] and, consequently, taxed where the property is located when the purpose of the services in question is the legal or physical alteration of that immovable property. This guideline has the following implications:

(1) legal services relating to the conveyance or the transfer of a title to immovable property, such as notary work, would fall within the scope of Art. 45 [which corresponds with Art. 47 of the current VAT Directive], since they have as their purpose the legal alteration of the immovable property.

(2) the drawing up of a contract to sell or acquire immovable property, even if the underlying transaction resulting in the legal alteration of that immovable property is not carried through, would nevertheless fall within the scope of Art. 45 [which corresponds with Art. 47 of the current VAT Directive], even if they form a supply distinct from the services mentioned in point (1);

(3) when services brought about the alteration of an item of immovable property are carried out, but the final transaction resulting in the alteration of that immovable property is not carried through, they would nevertheless fall within the scope of Art. 45 [which corresponds with Art. 47 of the current VAT Directive];

(4) the supply of legal work mentioned in points (2) and (3) will, however, not fall within Art. 45 [which corresponds with Art. 47 of the current VAT Directive], when it focuses on different aspects connected to contracts, which in general terms may concern any kind of legal matter and they are therefore not specific to the transfer of an item of immovable property.

(5) legal services relating to advice given on the terms of a contract to transfer immovable property, or to enforce such a contract, or to prove the existence of such a contract would not be covered by Art. 45 [which corresponds with Art. 47 of the current VAT Directive], if their immediate goal is not the legal alteration of the immovable property but the legal dispute over a contract. That said, where the aim of the legal work is the legal alteration of the immovable property, then the supply falls within Art. 45 [Art. 47 of the current VAT Directive], e.g. legal advice on a contract prior to signing to change the ownership of a property;

(6) in the situation where a more complex legal service (comprised of different elements) is supplied, the issue of a final tax determinate in order to assess whether Art. 45 [which corresponds with Art. 47 of the current VAT Directive] applies. This assessment would need to be done on a case-by-case basis.

5. In its 17th meeting, the VAT Committee adopted the following guideline: The great majority of the Committee held that services supplied by independent experts to insurance companies in respect of immovable property, [...] are covered by Art. 92(2)(a) [of the former Sixth Directive, which corresponds with Art. 47 of the current VAT Directive].

6. In its 31st meeting, the VAT Committee adopted the following guideline: The Committee unanimously considered that, when in the framework of a fair or similar exhibition, an enterprise intervenes between the exhibitor and the owner or organizer of the exhibition and, for an all-in price, supplies to the exhibitor, a complex package of services comprising, in addition to the provision of a stand, a number of other, related services, the whole package is to be regarded as a single service comprising various components which cannot and need not to be itemized according to their own place of taxation.

As to the place-of-supply rules, the delegations unanimously agreed that the provision of a single compound service should be subject to taxation in the Member State where the fair or exhibition is located, either on the grounds of Art. 92(2)(a) [of the former Sixth Directive, which corresponds with Art. 47 of the current VAT Directive] or based on Art. 92(2)(c), first indent [of the former Sixth Directive, which – as regards B2C transactions – corresponds with Art. 54(1) of the current VAT Directive].

7. Under Art. 31 of Implementing Regulation 282/2011, services supplied by intermediaries acting in the name and on behalf of another person consisting of the intermediation in the provision of accommodation in the hotel sector or in sectors having a similar function shall fall within the scope of:

(a) Art. 44, if supplied to a taxable person acting as such, or a non-taxable legal person deemed to be a taxable person; or

(b) Art. 46, if supplied to a non-taxable person.

8. See note 16.

9. Europol is a judicial cooperation body created to help provide safety within an area of freedom, security and justice. Europol was set up by
An increase in VAT fraud is a serious crime that affects the profits of which are huge; therefore Member States should give priority to finding the best way to combat it and share responsibilities for the protection of all Member States revenues.

VAT fraud causes a substantial loss of revenue for both Member States and the European Union as a whole. Also, it is very often connected to money laundering, forgery and may have links with terrorist financing.

VAT fraud affects markets and the competition between businesses. Therefore, there is a risk that legitimate companies would no longer be able to compete in a market environment where criminal organizations operate.

VAT fraud is increasingly likely to have a cross-border dimension, being organized in particular through so-called carousel schemes. Such schemes are usually carried out in the European Union by the same fraudsters using the same modus operandi.

Initially, carousel fraud only involved intra-Community supplies of goods. Recently, several Member States have been confronted with carousel fraud related to greenhouse gas emission allowances, where the crime is completely virtual and very difficult to investigate.

There are certain weaknesses within the current EU VAT system that make it vulnerable to fraud.

In their efforts to tackle VAT fraud in the sectors most affected by it, some Member States have taken temporary measures which derogate from the general VAT rules. Unfortunately, such solutions only move the fraud to other sectors or to other Member States.

There is no integrated policy or strategy at EU level for investigating and prosecuting VAT fraud; many times, the law enforcement and judicial authorities work independently and very often they do not involve all other affected Member States.

The following recommendations have resulted from the strategic meeting:

1. A common strategy to combat cross-border VAT fraud is needed so that Member States will no longer tackle serious VAT fraud in isolation;
2. The relevant EU and international legal instruments need to be implemented in practice in all the Member States and applied efficiently, in particular the instruments required for the tracing, freezing, confiscation and sharing of proceeds from VAT fraud;
3. Solutions at European level must be identified in order to:
   - ensure that all Member States have in place a legal framework allowing for the investigation and prosecution of cross-border VAT fraud, irrespective of the Member State(s) where the crime happened and the loss occurred;
   - approximate the definitions, levels of sanctions and statute of limitations in the Member States regarding VAT fraud;
   - ensure that all Member States are fully aware of the interpretation of the ne bis in idem principle, in the sense that a final decision taken in any EU country in administrative or criminal procedures cannot be followed by a criminal sanction for the same facts, when qualified as VAT fraud; and
4. More efficient cooperation between the administrative, judicial and law enforcement authorities at the national and international level is needed to ensure a swift exchange of information, joint actions, and a common decision on where it is best to investigate and prosecute the VAT fraud;
5. International police and judicial cooperation should be initiated at the earliest stage possible with support from Eurojust and Europol;
6. Cooperation and coordination should be the overriding issues in VAT fraud cases. Eurojust could assist the Member States to ensure from an early stage the coordination of actions, their follow-up through a coordination centre, a timely execution of requests for mutual legal assistance and the cooperation with third states;
7. The Member States should consider using more often the effective JITs tool in VAT fraud cases, with support from Eurojust and Europol;
8. Awareness of new VAT fraud mechanisms applied by fraudsters and of best practices in combating VAT fraud is often lacking in many Member States. There is a need for training sessions and topical meetings to address these issues;
9. A timely and properly informed Europol could act as an alert system for the investigators and prosecutors in all Member States. The creation of a permanent monitoring platform based on information and intelligence gathered by Europol would be desirable for a constant monitoring of the VAT fraud phenomenon and a better assessment of available intelligence;
10. The cooperation in the fight against VAT fraud should include third states, and should take a more uniform approach, as more and more often crime assets are concealed or converted outside the European Union;
11. It would be very useful to continue the discussions in a follow-up meeting, in the nearest possible future, with the involvement of EU institutions.

The Council of the European Union in February 2002, under Decision 2002/187, to improve the fight against serious crime by facilitating the optimal coordination of action for investigations and prosecutions covering the territory of more than one Member State with full respect for fundamental rights and freedoms. Eurojust is composed of 27 national members, one from each EU Member State. They are senior and experienced judges, prosecutors, or police officers of equivalent competence, who together form the College of Eurojust.
Green Paper – BusinessEurope’s comments

In June 2011, BusinessEurope commented on the elements in the VAT Green Paper. BusinessEurope identified numerous areas where the VAT system should be changed or improved. In the short term, BusinessEurope suggested focusing on:

- mini one-stop-shop scheme that was part of the VAT package and should be fully operational by 2015;
- harmonized implementation of the invoicing Directive, for instance by publishing implementing guidelines on e-invoicing;
- involvement of businesses in the legal process and practical implementation;
- involvement of businesses to identify and facilitate intra-European discussions on practical problems, for instance, through the Business Expert Group;
- obligations and risks being forced on businesses when entering into intra-Community trade, by asking for an in-depth analysis into the approach to tax the supply of goods like the supply of services at the place of the establishment of the customer and, in parallel, finding solutions that would cater for the need to reduce reporting obligations and the risk for legitimate business; and
- areas for derogations, exemptions and deductibility, carefully reviewing the areas with the aim of harmonizing and simplifying the rules, definitions and administrative practices based on best practices.

Green Paper – CFE Opinion Statement

In May 2011, the Confédération Fiscale Européenne (CFE) issued an Opinion Statement prepared by the CFE Fiscal Committee in response to the public consultation on the future of VAT (VAT Green Paper), conducted by the European Commission between December 2010 and May 2011.23

The CFE, inter alia:

- welcomed the idea of creating pan-European VAT groups;
- emphasized the need to reduce compliance risks caused by the use of 22 official languages in the European Union;
- recommended the adoption of unified single VAT returns; and
- advocated the introduction of the “single-window concept” with an electronic system for providing information by businesses to the tax authorities and enabling the tax authorities to access business information.

CFE Opinion Statement on the VAT Green Paper, Confédération Fiscale Européenne website.

Audit of Germany’s administrative cooperation – Court of Auditors

In 2006, the EU Court of Auditors informed the German Federal Court of Auditors that it was planning an audit mission covering administrative cooperation in the field of VAT. The audit was to focus on whether Germany had established the administrative and organizational structures for administrative cooperation and how cooperation was put into practice in cases of requests for assistance. The audit essentially covered the departments of the central liaison office. However, other authorities involved in administrative cooperation could also be included in the audit. In that framework, the Court of Auditors requested information to be provided by the central liaison office regarding the requests for information received and submitted in 2004/05. However, the Court of Auditors did not receive the requested information and, by its letter of 4 December 2006, the Federal Ministry of Finance gave notification that an audit by the Court of Auditors was not possible, since it had no legal basis. In this respect, the Ministry took the view that the Court of Auditors’ role is clearly limited to monitoring transactions which are directly connected with the Union’s revenue and expenditure, and that administrative cooperation does not concern the Union’s revenue. In addition, the organization of the tax authorities, tax audits and the recovery of taxes fall within the competence of the Member States (principle of subsidiarity).

On 25 May 2011, Advocate General Trstenjak delivered his Opinion relating to the infringement procedure before the ECJ of the European Commission against Germany (Case C-539/09). The AG concluded that, by refusing to permit the Court of Auditors to carry out audits in Germany concerning the administrative cooperation in the field of VAT, which is provided for under Regulation 1798/2003, and to assist it in this regard, Germany has failed to fulfil its obligations under Art. 10 EC, in conjunction with Art. 248(1) and (2) EC, Art. 248(3) EC, and Art. 140(2) of Regulation 1605/2002.

The AG also concluded that the ECJ should dismiss the Commission’s complaint that Germany has also infringed Art. 142(1) of Regulation 1605/2002, under which [...] the bodies administering revenue or expenditure on the Union’s behalf [...] must afford the Court of Auditors all the facilities and give it all the information which the Court of Auditors considers necessary for the performance of its task, on the ground that the Commission had not made

20. BusinessEurope is a horizontal business organization at EU level. Through its 40 member federations, BusinessEurope represents 20 million companies from 34 countries. Its main task is to ensure that companies’ interests are represented and defended vis-à-vis the European institutions with the principal aim of preserving and strengthening corporate competitiveness. BusinessEurope is active in the European social dialogue to promote the smooth functioning of labour markets.
23. Id.
24. Art. 10 EC has been replaced, in substance, by Art. 4(3) TFEU.
25. Art. 248 EC corresponds with Art. 287 TFEU; those provisions describe the competence of the Court of Auditors.
clear which German bodies might be classified as “bodies administering revenue on the Union’s behalf” in the context of the audit request by the Court of Auditors. Neither the central liaison office nor the Federal Ministry of Finance could readily be regarded as such bodies.

**Finland**

Postal services

With effect from 1 June 2011, specific postal services are exempt from VAT, i.e. delivery of letters up to 2 kg and parcels up to 10 kg, if the services form part of the “universal” postal service. The amendments to the VAT regime for postal services resulted from amendments to the VAT Act and Postal Act which were approved on 29 April 2011. The exemption is limited to situations in which the customer pays for the postal services by the use of a postage stamp or franking machine. Services supplied on the basis of individually negotiated contracts and services in respect of which the service provider issues an invoice remain subject to VAT.

From our correspondent Harri Huikuri
Deloitte & Touche Oy, Helsinki

Newspapers and periodicals

On 17 June 2011, the government announced that it had reached agreement on its programme entitled “An Open, Fair and Bold Finland”. Under the programme, subscriptions to newspapers and periodicals will become subject to the reduced rate of 9%. Currently, such subscriptions for a period of at least one month are zero rated.

**Germany**

Transfers of intangible assets

On 8 June 2011, the Federal Ministry of Finance issued official guidance regarding the VAT treatment of transfers of intangible assets, such as goodwill or customer base, following the judgment of the Court of Justice of the European Union in Swiss Re. In that judgment, the ECJ held that transfers of insurance or reinsurance contracts qualify as services and not as supplies of goods. According to the Federal Ministry of Finance, it follows from that judgment that transfers of other intangible assets, such as goodwill and customer base, must also be qualified as services within the meaning of Sec. 3(9)(1) of the VAT Act. Treating such transfers as supplies of services has the effect that the exemption under Art. 136(a) of the VAT Directive can no longer be applied.

This official guidance amends the Umsatzsteuer-Anwendungserlass (VAT Application Decree) of 1 October 2010 with immediate effect and also applies to all pending cases. However, the tax authorities will accept that those transfers are treated as supplies of goods until 1 July 2011.

Exemption versus zero rating

On 11 April 2011, the Ministry of Finance amended the Umsatzsteuer-Anwendungserlass (VAT Application De-

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28. ECJ judgment of 25 October 2001 in Commission of the European Communities v. Italian Republic, Case C-78/00, [2001] ECR I-8195. However, in that judgment, the ECJ held that, by providing that the category of taxable persons whose tax position for 1992 was in credit be belatedly issued with government bonds instead of refunds of the excess VAT, the Italian Republic had failed to fulfill its obligations under Arts. 17 and 18 of the Sixth Directive, as amended by Directive 93/7.
Introduction of GST – Update

The process of achieving consensus between state governments and between the central government and state governments on key issues relating to the introduction of state and central GST has slowed down as the Empowered Committee of State Finance Ministers has not met for some time. Following elections in West Bengal and the resulting change of government, the Finance Minister of that state, who was chairing the Empowered Committee, is no longer the Finance Minister of the state. The process of appointing a new chairperson is in progress. Subgroups constituted by the Empowered Committee to address specific issues continue their work and are meeting from time to time. However, it appears that, due to strong objections by some of the state governments, it may be difficult to maintain April 2012 as the date for introduction of nationwide GST. The proposed amendments to the Constitution for the introduction of GST have not yet been adopted and may not be adopted in the near future.

The Union Finance Minister is however continuing to pursue the matter and, in a recent meeting with commissioners of customs and excise, which was held in first week of June 2011, he mentioned that a pilot project establishing infrastructure for indirect taxation would be launched soon in 11 states. This pilot project would facilitate the roll-out of GST.

Taxation of services

The Union government has started discussions on one of the key policy issues relating to taxation of services, i.e. whether only designated services are subject to GST or all services, with the exception of designated services. The government has received views for and against the two approaches and the Ministry of Finance has opened this issue for public debate. The Ministry has urged various chambers of commerce and other stakeholders to indicate their views on the advantages and disadvantages of both approaches from an Indian perspective. On the basis of the results of the consultation, the government will draw up a position paper.

Restaurant services

Services provided by restaurants having air-conditioned facilities in any part of the restaurant and also having a licence to serve alcoholic beverages have become subject to service tax with effect from 1 May 2011. In that context, the Tax Research Unit (TRU) of the Ministry of Finance has provided several clarifications.

The most important clarification concerns the issue that, where a person or entity owns and operates more than one restaurant, only the services provided in the restaurant that fulfils the two conditions are subject to service tax, not the services provided in restaurants that do not fulfill the two conditions.

The TRU also clarified that, for the purposes of calculating service tax on restaurant transactions, the state tax due on those transactions is not included in the taxable base.

Short-term accommodation

The provision of short-term hotel accommodation for a daily charge of INR 1,000 or more has also become subject to service tax from 1 May 2011. In the context of that provision, the TRU clarified that the charge of INR 1,000 refers to the actual amounts charged to customers, i.e. published charges minus discounts. The charge does not include cost of food or beverages, if charged separately, and also does not include luxury tax, which is levied by the state governments.

Services by subcontractors

Specific services are exempt from service tax, for example works and contract services relating to the construction of infrastructural projects, such as dams, tunnels, roads, bridges, etc, and the exempt services concern engineering, procurement and construction (EPC) contracts. However, the main contractors involved in EPC contracts normally outsource specific services to subcontractors, such as architects, consulting engineers, designers, and subcontractors in charge of erection, commissioning, and installation services. The services of the subcontractors are categorized under separate headings and attract service tax because those headings do make an exception for services provided in relation to the construction of dams, tunnels, roads, bridges and other infrastructural projects.

The Central Board of Excise and Customs, Ministry of Finance, concluded that the circumstance that the services of main contractors are exempt from service tax does not necessarily mean that the services of their subcontractors are also exempt from VAT if the latter services must be categorized under a different heading. Consequently, the main contractors incur service tax on the services which they receive from subcontractors.

From our correspondent Bhavna Doshi

Bharat S Raut & Co., KPMG, Mumbai

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Latvia

Natural gas

On 27 April 2011, amendments to the VAT Law were published in the State Gazette. The amendments were adopted by the parliament on 14 April 2011.

With effect from 1 July 2011, the supply of natural gas to households is subject to the standard rate of 22%, instead of the reduced rate.

Lithuania

Council Decision – Registration threshold

On 30 May 2011, the Council of the European Union authorized Lithuania to increase its VAT registration threshold from the equivalent in national currency of EUR 29,000 to the equivalent of EUR 45,000.

The authorization applies from 1 January 2012 until 31 December 2014 or the earlier date of entry into force of a Directive amending the amounts of the annual turnover thresholds below which taxable persons may qualify for a VAT exemption.


Malawi

Standard rate

On 3 June 2011, the Minister of Finance presented the Budget for 2011-12 to the National Assembly. The measures contained in the Budget take immediate effect and, as regards VAT, include the application of the standard rate to:

– most products that were previously exempt;
– the following goods that were previously zero rated:
  – motor vehicles weighing less than 15 tonnes for transporting goods;
  – industrial and construction machinery, spare parts, trailers and semi-trailers; and
  – goods that were zero rated under the Customs Procedure Code.
– goods that were zero rated under the Customs Procedure Code.

On the other hand, table salt and hospital syringes are zero rated.

Finally, businesses in the banking sector will no longer be entitled to deduct input VAT.

Maldives

Tourism

The “Tourism Goods and Services Tax Act”, which was ratified by the President on 8 September 2010, became applicable on 1 January 2011. The most important conse-

34. In the terminology of the VAT Directive, the zero rate is an exemption.
quences of the Act are that all goods and services supplied to tourists in the Maldives, including services of operators of tourist resorts, hotels, guest houses and picnic islands, are subject to GST at the rate of 3.5%.

Any person who supplies goods or services to tourists must be registered and file monthly GST returns before the 28th day of the following month. In the event of late payment of the tax, the tax authorities will charge interest at the rate of 0.1% of the tax due per day for the first 30 days and 0.5% of the tax due per day for the days beyond the first 30 days. A violation of the Act will be punished by imposing a penalty of up to MVR 100,000.

**Moldova**

On 21 April 2011, the Ministry of Finance published on its website the draft Medium-Term Expenditures Framework (MTEF) for the years 2012-14, containing, inter alia, intended tax policy measures. In respect of VAT, the MTEF contains the following measures.

**Refund of VAT**

The arrangements for refunding VAT will be extended to include businesses entities making capital investments in the municipalities of Chisinau and Balti.

**Fixed assets**

The VAT exemption for fixed assets used as contribution to the owner’s equity of a company will be abolished.

**Netherlands**

**Private use of business cars**

Following the decision of the Rechtbank (Court of first instance) Haarlem of 1 June 2011, No. AWD 09/3866 (see “VAT Case Notes” in this issue), the Ministry of Finance will change the rules for taxation of private use of business cars by taxable persons and employees, with effect from 1 July 2011. The new rules are summarized in “VAT Case Notes”.

**Renovation and repair of dwellings**

By Public Notice of 1 June 2011, No. BLKB 2011/1000M, the State Secretary for Finance announced that the reduced VAT rate of 6% on the labour component of the costs of renovation and repair of “existing” dwellings can still be applied if the work is completed before 1 October 2011, provided that the renovation or repair commenced before 1 July 2011.

**Infringement procedure – Travel agents**

On 16 June 2011, the European Commission announced that it has referred the Netherlands to the Court of Justice of the European Union for its VAT scheme in respect of travel agents. Without the margin scheme, travel agents who combine services received from other service providers into travel packages that they sell in their own name would be subject to VAT in their own Member State on the value of the services included in the packages. They would also be entitled to a refund of the VAT charged to them by the non-resident service providers in respect of those services, which they must reclaim in the service providers’ Member States. Moreover, the price of the travel packages would be substantially influenced by the tax rate applicable in the travel agent’s Member State, even though the travel may take place in another Member State.

In order to avoid those complexities and anomalies, the margin scheme provides that all the elements of a travel package are taxed in the Member State where the travel takes place. The travel agent pays the VAT on those elements to the non-resident service providers and does not have the possibility to obtain a deduction or refund of that VAT. On the other hand, in respect of the supply of the total travel package, the travel agent only pays VAT in the Member State where he is established on his margin, i.e. the value added.

The Netherlands has not introduced the special margin scheme for travel agents into its VAT legislation and, instead, allows travel agents to apply the normal VAT rules, which is incompatible with the VAT Directive because application of the special scheme is obligatory.

In the accompanying press release of 16 June 2011, the Commission stated that, although the government of the Netherlands had indicated that the special scheme for travel agents would apply from 1 April 2011, the scheme still did not yet apply in June 2011.

However, either the government of the Netherlands or the Commission must have made a mistake in this context: the special scheme has been transposed into national law in December 2010 and those legal provisions are envisaged to enter into force on 1 April 2012 (not 1 April 2011). IP/11/716 of 16 June 2011.

**Norway**

**Repairs under warranty**

On 9 June 2011, the Ministry of Finance issued a discussion paper containing a proposal for the reintroduction of the zero rate for B2B repairs under warranty on behalf of non-resident businesses. The proposed zero rate applies to repairs of movable or immovable goods made in Norwegian.

37. Art. 306 of the Directive provides that the Member States must apply the special VAT scheme to transactions carried out by travel agents who deal with their customers in their own name and use supplies of goods and services provided by other taxable persons in the provision of travel facilities.
way, under a warranty given by a non-resident business. The measure is aimed at preventing non-resident businesses from having to apply for a refund of VAT, which not only constitutes a considerable administrative burden but, in view of the inefficiency of the procedure, also has a serious adverse cash flow effect.

The consultation ends on 9 August 2011.

From our correspondent Espen Qvist
PwC, Oslo

Pakistan

Standard rate
The Budget for the fiscal year 2011/12 was presented on 3 June 2011. Under the Budget, the standard rate of sales tax is reduced from 17% to 16%, with effect from 1 July 2011.

Panama

Exemption
Under Law No. 31 of 5 April 2011, the supply of, and services relating to, cement and additives for cement are exempt from VAT, provided that the cement is destined for the construction of the third set of locks in the Panama Canal.

Peru

Standard rate
The standard rate of VAT was reduced from 17% to 16%,39 with effect from 1 March 2011. Since, in addition to VAT, suppliers must also account for 2% municipal sales tax (IPM) on the basis of the same taxable amount, the effective rate of VAT was reduced from 19% to 18%.

Interest
Under Supreme Decree 099-2011-EF, which was published in the Official Gazette of 9 June 2011, interest derived from securities is exempt from VAT, provided that the securities are issued by entities established in Peru, are offered abroad (held by non-resident persons), and have a placement tranche in Peruvian territory, according to Peruvian securities law and Peruvian investments fund law.

Supreme Decree 099-2011-EF entered into force on 10 June 2011.

From our correspondent Alonso Rey Bustamante
Payet, Rey, Cauvi en Asociación Uría & Menéndez, Lima

Poland

The Sejm has adopted several amendments to the VAT Law, including the following measures. The amendments must still be approved by the Senate and signed by the president.

Passenger transport by road
Following the judgment of the Court of Justice of the European Union (ECJ) in the infringement procedure of the Commission against Poland,40 the government has proposed a new special procedure under which non-resident transport companies, that use buses which are not registered in Poland, may account for VAT on occasional passenger transport by bus in Poland which forms part of an international transportation of passengers. Under the proposed procedure, the transport companies can register and pay VAT electronically, on the condition that they refrain from recovering input VAT. The bus driver must possess a print-out of the confirmation that the transport company has been registered.

Right to deduct
In response to the judgment of the ECJ in Dankowski,41 the government has proposed to amend Art. 88(3a)(1) (a) of the VAT Law to the effect that VAT mentioned on invoices issued by persons who are formally not entitled to issue invoices or correcting invoices will no longer be excluded from the right to deduct.

Exchange rates
Under Art. 31a of the VAT Law, where the amount used for determining the taxable amount is expressed in a foreign currency, it must be converted into zloty on the basis of the average exchange rate42 published by the National Bank of Poland for the working day preceding the date on which the taxable event occurs. As a simplification measure in connection with the European Championship Football organized by Poland and Ukraine in 2012, fees for admission to mass events, which are expressed in a foreign currency, can also be converted into zloty on the basis of the customs conversion rules used for the purposes of calculating the customs value of imported goods whose value is expressed in a foreign currency.

Scrap materials
On 2 May 2011, the Ministry of Finance issued a ruling explaining its position on the interpretation of Art. 17(1)(7) of the VAT Law.43 Under that provision, which has been in force since 1 April 2004, the reverse charge mechanism applies to domestic supplies of scrap materials. Although it is rather clear that the legislator’s aim was to introduce the reverse charge mechanism in respect

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40. By its judgment of 6 May 2010 in European Commission v. Republic of Poland, Case C-311/09, the ECJ declared that, by charging VAT in the manner set out in the Regulation of 27 April 2004, under which non-resident transport companies had to account for VAT on national passenger transport at the rate of 7% on a flat amount of PLZ 285 (EUR 70) per passenger, Poland had failed to fulfil its obligations under Directive 2006/112.
41. By its judgment of 22 December 2010 in Bogusław Juliusz Dankowski v. Dyrektor Izby Skarbowej w Łodzi, Case C-438/09, the ECJ declared that a taxable person has the right to deduct VAT paid in respect of services supplied by another taxable person who is not registered for that tax, where the relevant invoices contain all the information required by the VAT Directive, in particular the information needed to identify the person who drew up those invoices and to ascertain the nature of the services provided.
42. Average of buying and selling rates.
of supplies of scrap metals, it has been questioned how broad the meaning of "scrap materials" is. According to the Ministry of Finance, the concept "scrap materials" does not only cover scrap metals (including, inter alia, steel and precious metals) but also used batteries and parts thereof.

Due to the interpretation problems, the Sejm (lower house of parliament) has adopted an amendment to the VAT Law. If it successfully goes through the whole legislative procedure, the reverse charge mechanism applies, from 1 July 2011, to the goods expressly mentioned in the VAT Law (including scrap glass, scrap rubber, as well as used batteries).

From our correspondent Krzysztof Lasinski-Sulecki Nicholas Copernicus University in Torun, Poland

Portugal

Memorandum of understanding

Portugal initiated a bail-out procedure in May 2011 under the conditions laid down by a Memorandum of Understanding (MoU) between the government, the European Commission, the International Monetary Fund and the European Central Bank. The MoU was approved by the parties that won the national elections of 5 June 2011.

The MoU encompasses measures to be implemented from 2011 until the end of 2013, which are aimed at substantive reductions of the budget deficit and total public debt. The programme is fully specified and balanced between expenditure and revenue measures, so as to successfully curb public expenditure and boost the country’s competitiveness. In order to reach the targets for 2012/13, it will be necessary to take measures with an effect equivalent to 5.1% of GDP, which include expenditure measures accounting for 3.4% of GDP and revenue measures accounting for 1.7% of GDP.

On the revenue side, the measures focus on increasing the share of consumption taxes and reducing tax privileges. The changes concerning VAT should achieve an additional yield of at least EUR 410 million for 2012.

The MoU contains the following VAT measures:

- reducing the scope of VAT exemptions;
- moving categories of goods, such as gas and electricity, and services from the reduced and intermediate rates of 6% and 13% to higher rates; and
- limiting the reduction of the VAT rates applicable in the autonomous regions to a maximum of 20% (currently 30%) of the rates applicable in the mainland. The VAT rates currently applicable in the Azores and Madeira are 4%, 9% and 16%, as compared to 6%, 13% and 23% in mainland Portugal.

The MoU does not contain an increase of the standard VAT rate of 23%.

In addition, in order to boost economic growth, the government will substantially reduce employers’ social security contributions, which may make it necessary to further change the VAT rate structure. While the agreed measures can be taken in two steps, the first step should be made in the context of the 2012 budget.

Finally, the MoU also contains substantial changes to the organization of the tax administration and tax judicial system.

As regards the tax administration, the measures include an increase in the human resources devoted to auditing to at least 30% of total staff, mostly by reallocating personnel, review of the results of audits on the basis of qualitative and quantitative criteria, and adoption of a comprehensive strategic plan to combat tax fraud and to strengthen auditing and collection procedures.

As regards the judicial system, a special task force of judges will be charged with handling cases with a financial interest of more than EUR 1 million, and special chambers will be established within the tax tribunals to handle large cases, with support of specialized technical staff.

From our correspondent Isabel Vieira dos Reis Garrigues, Lisbon

Romania

Registration procedure

At the end of May 2011, the Ministry of Public Finance published new rules for VAT registration of newly established businesses and businesses that, although their annual turnover is below the so-called registration threshold (of RON 119,000), opt for voluntary VAT registration.

The new conditions for VAT registration are as follows:

(a) the business must declare to the trade registry that it fulfils the legal sanitary, veterinary, environmental and work protection conditions in the framework of carrying out its registered activities, either at its main or secondary premises (to that end, the trade registry provides the applicant with a standard form);
(b) none of the directors or shareholders holding at least 15% of the company’s share capital have been held jointly liable for payment of damages in connection with an insolvent or bankrupt business, have been declared “inactive”, or have acted as legal representative of an “inactive business” (the applicant must state those facts in the so-called “tax record”, which must be drawn up by the applicant in accordance with Government Ordinance No. 75/2001);
(c) the applicant’s business premises must be appropriate for undertaking the planned or current activities. Compliance with this factual condition will be confirmed by the tax authorities following an inspection of the premises by the Financial Guard; and
(d) the applicant scores at least 45 points on the tax authorities’ "scorecard".
Fulfilment of the conditions under (a) and (b) will be checked by the tax authorities, within three days from the date of application for VAT registration, on the basis of the documentation, which must be provided by the applicant. Failure to comply with either of those conditions results in rejection of the application.

If they find that the applicant complies with the conditions under (a) and (b), the tax authorities will ask, within four days, the Financial Guard to verify compliance with condition (c). The Financial Guard must present its report within 15 days.

If they find that the applicant complies with the first three conditions, the tax authorities proceed by filling in a scorecard awarding points on the basis of various circumstances, including:
- the circumstance that the applicant owns or rents its business premises and, if they are rented, the length of the contractual rental period;
- the history of other businesses in which the directors and shareholders have been involved in the past;
- the place of residence of the directors: in Romania, in another EU Member State or in a country outside the European Union and, in the latter case, whether the director has obtained a long-stay visa.

The maximum number of points that can be awarded is 60. If the applicant’s score is less than 45 points, the tax authorities will reject the application for VAT registration.

Cereals

Under Emergency Ordinance No. 49, which was published in Official Gazette No. 381 of 31 May 2011, the Tax Code was amended to the effect of extending the scope of the reverse charge mechanism to domestic supplies of durum wheat, spelt for sowing, common wheat seeds, rye, barley, maize, soya bean (whether or not broken), rape and colza seeds (whether or not broken), sunflower seeds (whether or not broken) and sugar beets. The special measure applies until 31 May 2013.

Suppliers of the listed cereals must verify the VAT status of their customers before applying the measure, separately declare these transactions on their VAT returns, and keep a list of customers to which the measure was applied and, on request, present the list to the tax authorities.

On 4 May 2011, the Commission presented to the Council a proposal aimed at authorizing Romania to apply the requested special measure but the Council did not immediately accept it. On 23 May 2011, the Fiscal Counsellors/Attachés reached an agreement on the conditions under which the Council could grant the authorization. The conditions are that Romania uses the two-year period, during which the reverse charge mechanism applies, to introduce definitive measures compatible with the VAT Directive that would prevent and combat VAT evasion in the agricultural sector, and prevent the situation arising that the fraudulent activities are transferred to the processing stage of food or industrial goods, or to other products, or that the evasion spreads to other Member States. Romania must also introduce appropriate declaration and control measures in that framework, and notify the Commission thereof. Finally, Romania had to promise not to apply for renewal of the special measure. On 20 June 2011, the Council granted Romania the requested authorization.

It is expected that the government will soon announce further measures aimed at preventing evasion in the agricultural sector.

From our correspondent Ana-Maria Notinger
Tax adviser, Bucharest

Council Decision – Reverse charge mechanism

On 20 June 2011, the Council of the European Union authorized Romania to designate, by way of derogation from Art. 193 of Directive 2006/112, as the person liable to pay VAT the taxable recipient of supplies of the following goods, as set out in the Combined Nomenclature established by Regulation No. 2658/87:
- durum wheat;
- spelt for sowing;
- common wheat, seed;
- other spelt and common wheat, not for sowing;
- rye;
- barley;
- maize;
- soya beans, whether or not broken;
- rape or colza seeds, whether or not broken;
- sunflower seeds, whether or not broken; and
- sugar beets.

The authorization applies from 1 June 2011 until 31 May 2013.


Russia

E-invoicing (2)

Under current tax law, VAT invoices may be issued in electronic format only if the following conditions are fulfilled. The two parties must:
- agree that VAT invoices are exchanged between them in electronic format; and
- have appropriate technical resources and possibilities for receiving and processing electronic VAT invoices in accordance with established procedures.

By its Order No. 50n of 25 April 2011, the Ministry of Finance of the Russian Federation has published the procedures for issuing and receiving VAT invoices in electronic format. The Order entered into effect on 3 June 2011.

45. “Order on the adoption of the procedures for issuing and receiving VAT invoices in electronic format via telecommunications channels with the application of an electronic digital signature”. For the draft Order, see International VAT Monitor 3 (2011), p. 192.
Under the Order, electronic VAT invoices must be issued through specialized companies (“operators”), which must guarantee a secure exchange of confidential information between supplier and customer.

Electronic VAT invoices must be signed with an electronic signature of an authorized person of the supplier and must be forwarded to the customer through the operator, in accordance with the procedure laid down by the Order.

In order to be able to issue and receive VAT invoices in electronic format, companies must:
- obtain a certificate for an electronic signature to be issued in accordance with Law No. 1-FZ of 10 January 2002 “On electronic digital signature”;
- submit an application to the operator and provide the operator with the information required by the Order;
- conclude a contract with the operator and obtain the equipment and information necessary to access the electronic document flow system.

Amendments to electronic VAT invoices must also be processed through the operator. In that framework, the customer may forward, through the operator, a request to the supplier for amendment of a VAT invoice. Upon receipt of such a request, the supplier must correct the VAT invoice indicated in the request and forward, through the operator, the amended VAT invoice to the customer.

The law requires that the format of electronic VAT invoices is adopted by the Federal Tax Service of the Russian Federation. Since the Federal Tax Service has not yet adopted such a format, electronic invoicing can not yet be applied in practice.

From our correspondent Oleg Berezin Deloitte, Russia

St Lucia

Introduction of VAT
The Prime Minister and Minister for Finance, Economic Affairs and National Development presented the Budget for 2011/12 to the House of Assembly on 14 April 2011. Under the Budget, VAT will be introduced in April 2012.

South Africa

Imported goods and services – Threshold exemption
Any person who imports goods into South Africa has to pay VAT, unless an exemption applies. VAT is also payable on the importation of services, whether the recipient is a business or a private individual. However, VAT on imported services is not payable if the recipient will use the services for the purposes of making taxable supplies.

While a minimum threshold exemption of ZAR 100 per parcel applies to the importation of goods, a similar exemption does not apply to the VAT payable on imported services under the reverse charge mechanism.

In terms of draft VAT amendments published for comment in June 2011, it has been proposed that a minimum threshold exemption of ZAR 500 be introduced for imported services and that the minimum threshold exemption for imported goods be increased to ZAR 500.

Removal of imported goods from bonded warehouse
VAT is not payable when imported goods are entered into a bonded warehouse (subject to certain requirements) and also the sale of goods stored in a bonded warehouse is not subject to VAT. VAT will become payable only when the goods are removed from a bonded warehouse and entered for home consumption.

As the VAT Act does not provide for the value at which VAT is payable when goods are ultimately removed from a bonded warehouse, the person who enters the goods for home consumption will often rely on the value for customs purposes, i.e. the value when the goods were entered into the country for storage purposes.

Under the proposed amendments, the value on which VAT is payable when goods are brought into free circulation will be the greater of the original customs value and the value of the goods at the time they are removed from a bonded warehouse.

From our correspondent Marlene Botes PwC South Africa, Cape Town

Spain

Infringement procedure – Medical items
On 19 May 2011, the European Commission announced that it has referred Spain to the Court of Justice of the European Union for its broad application of the reduced VAT rate to supplies of medical equipment.

Under the VAT Directive, Member States may apply a reduced VAT rate to medical equipment, aids and other appliances which are normally intended to alleviate or treat disability, and which are for the exclusive personal use of the disabled. However, Spain also applies the reduced rate to medical equipment for general use, and to equipment used for disabled animals, which goes beyond the scope of the provision of the VAT Directive.

In addition, the VAT Directive allows the application of a reduced rate to pharmaceutical products which are normally used for health care, prevention of illnesses and as treatment for medical and veterinary purposes. Spain also applies the reduced rate to medical substances used for the production of medicines, which also is not allowed under the EU VAT Directive.


Sweden

Reduced rate
On 31 May 2011, the government presented a proposal to the Advisory Council on Legislation on the VAT rate on restaurant and catering services (excluding alcoholic beverages) from 25% to 12%, i.e. the same rate that also applies to, inter alia, supplies of foodstuffs and provision of hotel accommodation. The proposal is aimed at simplifying the VAT rules and at achieving a positive effect on the economy, in particular on long-term employment.

Provided that the economic situation allows it, the change is proposed to enter into force on 1 January 2012.

From our correspondent Tomas Karlsson
Ernst & Young AB, Stockholm

Switzerland

Tax-free arrangements for tourists
The federal tax administration has recently published the conditions for VAT exemption for goods purchased by non-resident tourists. The exemption applies under the following conditions:
- the price of all purchased goods must be at least CHF 300 (including VAT);
- the purchaser may not be resident in Switzerland;
- the goods must be intended for private use or as gifts; and
- the goods must be taken or sent abroad by, at the latest, 30 days after the purchase.

Proof of export of the purchased goods can be provided in the form of:
- an export form endorsed by the Swiss customs when the purchaser leaves Switzerland;
- an export form certified by a Swiss embassy/consulate in the country of residence of the purchaser or an uncertified export form, together with an official import document in the country where the purchaser is resident.

Export documents must be made out in the purchaser’s name and may only list items that the purchaser exports personally. They must be drawn up in one of the official languages of Switzerland or in English.

Only the seller may claim the exemption. The tax authorities will not refund the VAT to the purchaser. In the case of a disagreement regarding VAT, a civil court will hear the case.

Special arrangements apply to groups of travellers or tourists. Suppliers who hold a special licence may zero rate supplies of goods to members of the group.

Turks and Caicos Islands

Introduction of VAT
The Permanent Secretary for Finance presented the Budget for 2011/12 to the Consultative Forum on 5 April 2011. Under the Budget, VAT will be introduced on 1 April 2013.

Uganda

Solar energy – Ambulances
On 8 June 2011, the Minister of Finance, Planning and Economic Development presented the Budget for 2011/12 to Parliament. The measures contained in the Budget are envisaged to take effect on 1 July 2011 and, as regards VAT, include exemptions for the supply of solar energy and ambulances.

United Kingdom

Hot takeaway food (2)
The tax authorities (Her Majesty’s Revenue and Customs, HMRC) have released a statement (Brief 19/11) to the effect that the ECJ judgment on Bog and others has no impact on the zero rating of supplies of food in the United Kingdom. In Bog, the issue was whether the supply of hot food prepared for immediate consumption was a supply of goods or services. The ECJ concluded that the supply was a supply of goods, as the service element did not predominate in the transaction, and that the supply fell within the meaning of foodstuffs in Annex III to the VAT Directive and, therefore, could be taxed at the reduced rate in Germany. In the United Kingdom, supplies of most foodstuffs are zero rated, with the exception of supplies made in the course of catering. Food consumed on the premises where it is supplied, and hot food (as defined) consumed off those premises are considered to

47. The “Advisory Council on Legislation” (Sw. Lagrådet) is an advisory council under the Swedish parliament that comments on proposed legislation to guarantee that the proposed legislation is in line with the Swedish Constitution. The comments from the “Advisory Council” are not binding for the government.
- the supply of food or meals freshly prepared for immediate consumption from snack stalls or mobile snack bars or in cinema foyers is a supply of goods, if a qualitative examination of the entire transaction shows that the elements of supply of services preceding and accompanying the supply of the food are not predominant;
- except in cases in which a party caterer does no more than deliver standard meals without any additional elements of supply of services, or in which other special circumstances show that the supply of the food represents the predominant element of a transaction, the activities of a party caterer are supplies of services.
- In cases of supplies of goods, the term “foodstuffs” also covers food and meals which have been prepared for immediate consumption by boiling, grilling, roasting, baking or other means.
be supplied in the course of catering and, on that ground, excluded from the zero rate. HMRC has stated that hot food is specifically excluded from the UK relief and so there is no intention to zero rate it.

**Taxed intra-Community acquisitions**

Following the judgment of the ECJ in X and Facet, HMRC has announced a change in VAT treatment, where a business uses a UK VAT identification number to secure zero rating of supplies of goods sent from one EU Member State to another, without physically arriving in the United Kingdom. Under those circumstances, the party which uses its UK VAT identification number must, with effect from 1 June 2011, account for VAT on the intra-Community acquisition in the United Kingdom under the safety net provision, and will not be entitled to claim a deduction of that VAT. The UK acquisition VAT can only be refunded to the party if that party shows that it has accounted for VAT on the intra-Community acquisition in the Member State of final destination of the goods. This change of policy does not affect the intermediate party that uses a UK VAT identification number in the framework of the simplified arrangements for intra-Community triangulation.

Brief 20/11.

From our correspondent Karen Killington
KPMG UK LLP

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**Arizona**

**Click-through nexus**

The so-called “click-through” nexus bill (HB 2551) died upon adjournment of the Legislature on 20 April 2011. If adopted, the bill would have created a rebuttable presumption that a person resident outside Arizona making sales of tangible personal property to customers in Arizona was conducting business in Arizona for transaction privilege tax purposes if the seller contracted with a resident of Arizona who, for a commission or other consideration, directly or indirectly, referred potential customers to the seller through a link on an Internet website or otherwise, and the cumulative gross income or gross proceeds from such referred sales exceeded a threshold amount.

House Bill 2551.

**California**

**Off-the-shelf software**

The California State Board of Equalization (BOE) has announced that it has authorized the amendment of a regulation to make it consistent with a recent decision of the California Court of Appeal that sales tax does not apply to interests in patents and copyrights transferred with prewritten (or canned) software in a technology transfer agreement (TTA).

The amendment of the regulation does not affect the way sales tax is applied to the typical off-the-shelf retail sale of canned, mass-marketed software because the typical retailer does not hold any copyright or patent interests in the software. The regulatory change only clarifies that, when the holder of copyrights or patents also sells that intellectual property to another in a technology transfer agreement that includes the transfer of software, the amount charged for the copyrights or patents is not subject to sales tax.

According to the BOE, court decisions have confirmed that canned software is taxable and intellectual property is not subject to tax. After getting feedback from the industry, the BOE will provide further guidance on how tax applies to sales of software.


**Idaho**

**Tips for serving meals**

With retroactive effect to 1 January 2011, gratuities or tips paid to the person who serves a meal are not subject to state sales and use tax. Gratuities or tips can be voluntary or mandatory and must be given for the service provided and as a supplement to the service provider’s income.

Ch. 230 (HB 213), Laws 2011.

**Illinois**

**E-commerce authentication and digital certificates**

The Department of Revenue has issued a general information letter discussing the application of sales and use tax provisions to sales of authentication and resolution services provided to customers to secure electronic commerce and Internet communications through the provision of digital certificates. The provision of a digital certificate, authentication and resolution services is generally not taxable. Canned computer software or any other tangible personal property provided to the customer with the digital certificate or services may be taxable. Furthermore, a digital signature or identification is not taxable because it is not considered computer software, but software used to create, encrypt, decrypt or read a digital signature is considered software that may be taxable.


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51. Transaction privilege tax (TPT) refers to a gross receipts tax levied by the State of Arizona on certain persons for the privilege of conducting business in the state. TPT differs from the “true” sales tax imposed by many other US states as it is imposed on the seller or lessor rather than the purchaser or lessee. The seller/lessor may pass the burden of the tax on to the purchaser/lessee, but the seller or lessor is the party that remains ultimately liable to Arizona for the tax.

**Click-through nexus**

On 1 June 2011, the Performance Marketing Association, Inc. (PMA), a trade association representing the performance marketing industry, filed a lawsuit in the US District Court for the Northern District of Illinois against the Illinois Department of Revenue, seeking that the court hold Illinois HB 3659 in violation of both the Commerce Clause of the US Constitution and the federal Internet Tax Freedom Act.

On 10 March 2011, Illinois enacted HB 3659, a so-called “click-through nexus” bill, which provides that certain out-of-state sellers will be considered retailers or servicemen maintaining a place of business in Illinois, and thus will be required to collect use or service use tax on items or services sold for use in Illinois.

The PMA alleges that:

1. a link on the websites of publishers located in Illinois is insufficient to constitute “substantial nexus” between Illinois and an out-of-state retailer;

2. the expanded definition of “retailer maintaining a place of business in this state” violates the Commerce Clause by including transactions between non-Illinois retailers and non-Illinois purchasers and requiring affected Internet retailers to register for tax reporting on the basis of sales occurring outside Illinois; and

3. the tax is discriminatory against Internet-based transactions.


**Maine**

**Marijuana**

State marijuana laws are being reformed by establishing a special tax rate for marijuana, legalizing the personal use and cultivation of marijuana, legalizing and licensing certain commercial marijuana-related activities, while providing provisions to protect minors, employers and schools, and removing the registry system from the Maine Medical Use of Marijuana Act. Part A of the bill establishes a tax rate of 7%, beginning on 1 January 2012, for marijuana that is sold for commercial or medical purposes.

2011 ME H 1067.

**Massachusetts**

**Bundled cellular telephones**

The Massachusetts Department of Revenue has issued a directive that changes the rules used to compute sales and use tax on cellular telephones and other wireless communications devices sold in bundled transactions in which the customer pays a reduced price on the telephone or device if he or she enters into a contract for telecommunications services at the time of purchase.

From 1 July 2011, when a cellular telephone or other wireless communications device is sold in a bundled transaction that includes taxable telecommunications services, the taxable sales price of the telephone or device is the higher of the price paid by the retail customer or the wholesale cost of the telephone or device. The rule is the same whether the vendor is an independent retailer, including a franchisee of a telecommunications carrier, or a telecommunications carrier.

Generally, the vendor is responsible for collecting and remitting tax on the sale. When the wholesale cost is used to calculate the tax, the vendor may collect tax from the customer on the wholesale cost, or the vendor may elect to absorb a portion of the tax and collect tax from the customer on the lesser amount paid by the customer. In either situation, the tax paid by the customer must be separately stated on any invoice or receipt issued to the customer.

Directive 11-2, Massachusetts Department of Revenue, 27 April 2011.

**North Dakota**

**Non-profit social and recreational clubs**

Gross receipts from memberships, admissions, and entrance fees to activities and events organized and operated by non-profit social and recreation clubs are exempt from sales and use tax. The activities and events must be operated solely by non-salaried officers and staff.

HB 1334, Laws 2011, effective for taxable events occurring after 30 June 2011.

**Vermont**

**Click-through nexus**

The governor of Vermont has signed legislation that includes a so-called “click-through nexus” provision and requires remote sellers to give their purchasers notice that Vermont use tax is due on non-exempt purchases.

The “click-through nexus” provision provides that a person making sales that are subject to sales and use tax is presumed to be soliciting business through an independent contractor, agent, or other representative if the person enters into an agreement with a Vermont resident under which the resident, for a commission or other consideration, directly or indirectly, refers potential customers by a link on an Internet website, or by other means, to the person. The presumption applies only if the cumulative gross receipts from sales by the person to customers in Vermont, who are referred to the person by all residents with this type of agreement with the person, exceed USD 10,000 during the preceding tax year. The presumption can be rebutted by proof that the resident with whom the person has an agreement did not engage in any solicitation in Vermont on behalf of the person that would satisfy the nexus requirements of the US Constitution during the tax year in question. The provision is envisaged to come into effect on the date when 15 or more other states have adopted requirements that are the same, substantially similar, or significantly comparable to Vermont’s

Remote retailers who are currently not required to collect Vermont sales or use taxes on sales for use in Vermont and online auction websites (OAWs) are required to notify their customers that Vermont use tax is due on non-exempt purchases of tangible personal property, services, or products transferred electronically and that such tax must be paid by the Vermont purchaser. The requirement is scheduled to be repealed when the “click-through nexus” provision comes into effect.

De minimis retailers and de minimis OAWs are exempt from the notice requirements. The de minimis requirement is satisfied if the remote retailer made total gross sales, or the OAW facilitated total gross sales, in Vermont in the prior calendar year of less than USD 100,000 and reasonably expects to make or facilitate total gross sales in Vermont of less than USD 100,000 in the current calendar year.


Washington

Manufacturing exemption for public institutions

The Washington Senate has passed a bill that would clarify and reaffirm that, for purposes of the sales and use tax exemption for machinery and equipment used directly in a solar energy system capable of generating 10 kW of electricity, the term does not include any activity that falls within the purview of the state public utility tax. The bill would also create a permanent sales and use tax exemption for sales of machinery and equipment to a public research institution to be used primarily in a renewable energy system; and installation charges. The buyer may then apply to the department for a refund of 75% of state and local sales taxes paid.

From 1 July 2011 until 30 June 2013, the buyer of a solar energy system capable of generating more than 10 kW of electricity must pay the total amount of sales tax due on the purchase of machinery and equipment, and installation charges. The buyer may then apply to the department for a refund of 75% of the state and local sales taxes paid.

The refund programme for solar energy systems producing more than 10 kW of electricity and renewable energy systems generating at least 1 kW of electricity, remains in force until 1 July 2013.

The 100% exemption for machinery and equipment used directly in a solar energy system capable of generating 10 kW of electricity or less, and for accompanying installation charges, remains in force until 1 July 2013.

Washington Department of Revenue, Special Notice of 7 June 2011.

From our correspondent Robert van Brederode

New York University, School of Law, New York, NY

Venezuela

Housing programme

Under Decree No. 8,174, which was published in Official Gazette No. 39,665 of 3 May 2011, the importation and supply of 52 categories of construction materials and certain services for the construction and restoration of residential immovable property in the framework of the new housing programme are exempt from VAT, with effect from 3 May 2011.

Vietnam

Duty-free imported fixed assets

Under the letter of the General Department of Customs of 16 March 2011, No. 1101/TCHQ-TXNK, enterprises are not required to declare and pay VAT on the importation of goods that were imported free of duty and VAT on the ground that they were destined to be used as fixed assets in a special investment project, if the goods are subsequently re-exported by reason of a reduction in production scale.
Medical care – Mental suggestion
By its decision of 29 July 2010, No. 2008/15/0291, the Verwaltungsgerichtshof declared that the services of practitioners of “mental suggestion” do not qualify for the exemption for medical care laid down by Sec. 6(19) of the VAT Act. Sec. 6(19) corresponds with Art. 132(1)(c) of the VAT Directive, which provides for exemption for medical care in the exercise of the medical and paramedical professions as defined by the Member State concerned. Practitioners of “mental suggestion” treat patients during individual therapeutic sessions by means of hypnosis and mental suggestion, and are not designated as paramedical professionals in the sense of Sec. 6(19).

Proof of export
By its decision of 17 February 2011, No. RV/0160-W/08, the Unabhängige Finanzsenat stated that scanned export documents cannot be used as proof of export on the ground that the authenticity of the customs stamp cannot be established.

From our correspondent Hannes Gürtnner
Leitner+Leitner, Linz

Canada

Deposits
Tendances et Concepts Inc. v. R., [2011] GSTC 41 (Tax Court of Canada (Informal Procedure))

This is the first case to explore in detail the meaning of “deposit” for GST purposes.

Under Subsec. 168(9), a deposit “shall not be considered as consideration paid for the supply unless and until the supplier applies the deposit as consideration for the supply”.

TCI built kitchen and bathroom cabinets. It would contract with a purchaser for a new kitchen or bathroom and, under the contract, would take a 30% deposit (of the total price including GST and Quebec sales tax) on signing the contract. A further 60% was payable on delivery, and a final 10% payable on installation. However, TCI did not remit GST and QST on the contract price until it completed delivery.

Revenu Quebec (RQ), which administers the GST in Quebec, assessed TCI for a one-month period¹ (May 2008) for the tax on the 30% it had collected, on the basis that the amount paid was a payment on account rather than a deposit. TCI appealed to the Tax Court of Canada.

Justice Robert Hogan dismissed the appeal, finding that the 30% was a payment on account, not a deposit. The Court reviewed in detail the meaning of “arrhes” in French and “deposit” in English, under the case law and in legal dictionaries. Justice Hogan took into account that this matter arose in Quebec, where the Civil Code applies (and where the term “arrhes” was used only in the pre-1994 Civil Code), but concluded that the interpretation would be the same in common-law provinces. A “deposit” is typically an amount that the parties agree will determine the damages forfeited if the customer does not complete the contract so that both parties can walk away. It is a guarantee of the execution of the contract. In contrast, a “payment on account” is a partial payment towards the full contract price which is payable in any event.

In this case, the 30% paid up front was paid towards TCI’s materials costs in manufacturing the cabinets, but it was not described in the contract as damages payable if the customer refused delivery. Rather, the customer was liable for the full contract price. Furthermore, the contract itself called the 30% an “acompte” (payment on account) and not a “deposit” (deposit). As a result, the 30% was not a deposit.

Furthermore, since TCI collected 30% of the tax-included contract price up front, it was really collecting taxes on the 30%, because GST and QST were explicitly included in the calculation of the 30%. As the Court noted (Para. 56), these “collected” amounts of tax were remittable.

Indeed, although the Court did not cite the supporting legislation and case law, amounts collected “as or on account of” GST are included in net tax under Subsec. 225(1) and must be remitted even if they were not payable.² Thus, in my view RQ could have assessed TCI on the basis that TCI had collected GST and QST which had to be remitted, without even considering the meaning of “deposit”.

This case will be a very useful reference for any future analysis of the meaning of “deposit” and “arrhes”. To avoid having to remit the GST on a deposit in future, it would seem that businesses such as TCI will need to contract to have the deposit be forfeited without further recourse if the customer walks away. Since most businesses would not want to give up their right to pursue the customer for full payment of the contract price, this may effectively mean that all such “deposits” towards home construction or renovation contracts will be considered payments on account that trigger remittance of GST/HST.

CRA assessment

This was a fascinating attempt to use the Federal Court to prevent a CRA assessment action. It was shot down by the Federal Court of Appeal.

¹. Since the assessment was only for one month, this appears to have been a “test case”.
The case arises from uncertainty over the GST treatment of international roaming charges for mobile phones. The CRA changed its interpretation in 2006 to treat such charges as part of the single supply of taxable telecommunication services rather than as separate charges which might be supplies made outside Canada under Sec. 142.1. This change was based on reviewing how Bell Canada treated such charges, and noting that Bell had done this since fall 2004.

The CRA communicated its new position to Telus in 2006, and Telus apparently started charging GST at that time based on the CRA’s interpretation. The CRA then audited Telus and proposed to assess it for GST not collected since 2004 under the new interpretation. Obviously, Telus must have signed a waiver under Subsec. 298(7) if months back to 2004 were still open for assessment in 2011.

One would think that Telus would simply object to the assessment and then appeal it to the Tax Court of Canada. However, Telus was not (yet) saying that the proposed assessment was wrong. Instead, it was saying that the CRA should not be assessing Telus back to 2004, because the CRA is relying on “irrelevant factors and erroneous assumptions” in seeking that starting point. Specifically, the CRA wrote to Telus to say that the reason it would be assessing back to 2004 was that “the industry began treating these services as a single supply at this point in time”, and the assessment “provides the CRA with the opportunity to apply the provisions of the ETA in a consistent manner”.

Telus (and another company in the same position, MTS Allstream) thus brought an application for judicial review, seeking a “writ of prohibition” to prevent the CRA from issuing the assessment. The Crown moved to strike the application on the basis that it could not possibly succeed.

There was no question that, once the assessment was issued, the Federal Court would have no jurisdiction over it and it would be appealable only to the Tax Court of Canada. See Sec. 12 of the Tax Court of Canada Act, and Sec. 18.5 of the Federal Courts Act.

The Federal Court, at [2010] GSTC 123, denied the Crown’s motion to strike the application, ruling that while Telus had a “steep hill to climb”, its application was “not clearly bereft of any chance of success”.

The Crown appealed this decision to the Federal Court of Appeal, which has overturned the Federal Court decision. With brief reasons, the Court of Appeal granted the Crown’s motion to strike, on the basis that it was “plain and obvious” that the judicial review application could not succeed.

In my view, the Court of Appeal’s decision is correct, though Telus’s counsel must be given full marks for creativity.

If the proposed assessment is incorrect (so that the charges in question are not subject to GST), then Telus can successfully appeal the assessment to the Tax Court of Canada. If the proposed assessment is correct, then by definition there cannot be any “irrelevant factors” in the CRA’s decision to assess, since it is issuing a correct assessment.

It is true that, as counsel for Telus pointed out, Subsec. 296(1) provides that the Minister “may” assess GST while the parallel income tax rule provides that the Minister “shall” assess. However, nothing turns on this point. Subsec. 275(1) provides that the Minister “shall administer and enforce” the GST/HST legislation. If the CRA believes the assessment is correct, it has the authority to issue it, and if the assessment is correct, it should stand.

The Court of Appeal focused (Paras. 3-4) on the alleged unfairness and hardship to Telus if the assessment is issued, and ruled that this could not be a reason to prevent the assessment. That is undoubtedly correct. With respect, however, Telus’s argument was really that the CRA was going to issue the assessment for the wrong reasons. The Court of Appeal did not comment on this issue, other than to note that Telus “may have other recourses” if the CRA “has exercised its discretion in a manner that has improperly caused Telus damage”. Curiously, the Court of Appeal stated (Para. 6) that “to the extent that the exercise of discretion affects the amount of tax owing, Telus may challenge the assessment in accordance with Part IX of the Excise Tax Act”. With respect, this is not correct, in light of Main Rehabilitation and other cases holding that the Tax Court cannot consider anything other than the correctness of the assessment.

Telus is one of a number of cases progressing through the Courts that test the extent to which the Federal Court can be used for remedies not available in the Tax Court. Taxpayers aggrieved by CRA audit and collection actions can bring an action for damages in the Federal Court (or in a provincial superior court, as permitted by the Crown Liability and Proceedings Act). When they do, they are usually met by a CRA attempt to strike the action as infringing on the Tax Court’s exclusive jurisdiction to determine the correctness of an assessment. Yet taxpayers who appeal to the Tax Court are told that they cannot raise any issue other than the correctness of the assessment, and that the CRA’s actions in the audit and collection process are irrelevant to the Tax Court appeal! It is possible to stickhandle through this jurisdictional obstacle course, if one does so carefully.

In my view, there should indeed be a remedy in the Federal Court and the provincial courts when the CRA oversteps its bounds and wrongfully causes damage to a taxpayer. However, Telus is not such a case. If the CRA believes that an assessment is correct, it is within its rights to issue the assessment. If the CRA had acted wrongfully in taking some action that resulted in detrimental reliance by Telus, then Telus could have an action for damages based on such reliance. But deciding to assess as of a particular date in order to assess all companies in the same industry

3. This is a historic anomaly resulting from the fact that, before April 2007, most GST returns were merely processed with no Notice of Assessment issued.
consistently is within the CRA’s jurisdiction. Such action is not done maliciously, and while the result may seem unfair to Telus, it is not outside the realm of what a taxing authority may reasonably do. Preventing the CRA from assessing would have been an interference with the CRA’s mandate to administer the GST/HST system.

Finally, note that Telus can recover from its customers the GST assessed, as provided by Sec. 224. Para. 225(4)(c) gives customers that are businesses the right to claim input tax credits (ITCs) for such GST even after the normal four-year ITC limitation period. Telus might thus simply add the extra GST it is assessed to customers’ bills. Of course, this will not work to the extent customers have changed carriers and are no longer using Telus, and even for continuing customers it might cause public relations problems for Telus.

The saga is not over. Telus (and MTS Allstream) have applied for leave to appeal this decision to the Supreme Court of Canada. Perhaps the Supreme Court will accept this case as an opportunity to explore the jurisdictional problems facing those who cannot find a remedy for CRA action in either the Federal Court or the Tax Court.

Directors’ liability

Buckingham v. R., [2011] GSTC 74 (Federal Court of Appeal, on appeal from [2010] GSTC 71)

This is a strong and clear judgment from the Federal Court of Appeal on the due-diligence defence to directors’ liability for unremitted GST and source deductions. It is a seminal case that resolves three important issues which have been the subject of many conflicting decisions.

The Court of Appeal has ruled: (1) that the tests for income tax and GST are the same; (2) that the due-diligence standard is an “objective” one; and (3) that after-the-fact efforts, after the failure to remit, do not save the director. The result is unfortunate for this particular director but goes a long way towards clarifying the law.

Buckingham was the chairman, and a director, of a public company (Mosaic Technologies Corp.) and subsidiaries that went out of business in 2003 with unremitted source deductions and GST net tax. He was assessed some CAD 500,000 for the source deductions (including interest and penalties). He appealed.

The Tax Court of Canada, at [2010] GSTC 71, dismissed Buckingham’s GST appeal but allowed his income tax appeal.

The Tax Court reviewed the long-established Soper (FCA 1997) “objective-subjective” standard of due diligence, and the revision of that standard to “objective” by the Supreme Court of Canada in 2004 in Peoples Department Stores. Although Peoples interprets identical wording, its application to source deduction and GST assessments was uncertain, because it was decided under the Canada Business Corporation Act (CBCA) and there is no provision parallel to CBCA Para. 122(1)(a) to deal with the “subjective motivation”. The Tax Court concluded, in light of several conflicting decisions, that the Peoples test displaces the Soper test, so that there is only a single “objective” standard.

The Tax Court held that the Soper distinction between “inside” and “outside” directors was still valid, and ruled that Buckingham was an “inside” director, as he was clearly very involved in the company’s operations.

The Tax Court thought it fallacious to say that a company is “stealing trust funds” when it fails to remit payroll deductions. In theory the company is “withholding” taxes and other deductions from employees’ pay. In practice, in the Tax Court’s view, if CAD 25,000 is withheld from CAD 100,000 of pay but the company has only CAD 75,000 in the bank, it pays the employees the CAD 75,000 and no money is actually being “withheld”. The Tax Court considered the situation to be different for GST, where payment is actually received. With respect, however, GST liability arises based on when the invoice is issued even if funds have not yet been received. Also, the liability is reduced by available input tax credits, so one cannot really point to any receipt of funds and say that those funds should have been remitted as GST.

Mosaic had hired additional employees in expectation of a contract with Nortel. The contract fell apart after 11 September 2001 when the economy ran into trouble. As Mosaic was running into financial difficulty, Buckingham made efforts to sell assets, and several of these efforts almost succeeded. In light of these efforts, the Tax Court ruled that Buckingham should not have been expected to shut down Mosaic as soon as it was unable to meet its current withholding remittance obligations. As a result, the Tax Court ruled that Buckingham met the due-diligence test for income tax purposes.

On the GST side, Buckingham claimed that a GST refund was expected and so remittances were not made. However, this position was not backed up by sufficient evidence. The Tax Court found that Buckingham had not taken reasonable steps to ensure that the GST collected was remitted. As a result, the Tax Court found Buckingham liable for the GST portion of the assessment.

The Crown and Buckingham both appealed to the Federal Court of Appeal, which found Buckingham liable for both the income tax and the GST.

First, the tests for income tax and GST are the same: one cannot find due diligence in one case and not in the other on the same facts, as there is “no fundamental conceptual difference” between them (Para. 42). This makes sense in my view, given that the language of the two provisions is identical.

The Court of Appeal rejected (Para. 45) the Tax Court’s conclusion that the fact the company had no cash to pay the withholdings meant that income tax was not actually being withheld. The Court of Appeal noted that the “en-
tire scheme” of the directors’ liability rule “is precisely designed to avoid” the situation where a director “condones the continued operation of the corporation by diverting employee source deductions to other purposes” (Para. 56). This is certainly correct. Directors are now on notice that if they continue to operate the business in the hope that ensuing profits will be sufficient to pay their GST and source deduction debts, they will be personally liable if things do not work out.

Second, the Court of Appeal ruled that Peoples has displaced Soper. The due-diligence standard is purely an “objective” one, and does not take into account the directors’ “personal skills, knowledge, abilities and capacities” (Para. 38). At the same time, however, the director’s “particular circumstances” are to be considered, albeit measured against a “reasonably prudent person” standard (Para. 39).

With respect, it seems unfair to completely ignore the particular director’s education and experience. The Courts have consistently held directors with little education and business experience to a lower standard. Is this part of the “objective” determination of the director’s “particular circumstances”, or is it part of a (now invalid) “subjective” test of “personal skills, knowledge, abilities and capacities”? One suspects that the Tax Court will continue to find ways to give a break to the uneducated director who had no comprehension of what it meant to be a director and was relying on a dominant family member or other director.

Third, the Court of Appeal ruled that efforts to get the company to pay its GST debt do not help the director, because they are not relevant to the director’s duty to prevent the failure to remit in the first place. The focus of the due-diligence defence “is to prevent the failure to remit, not to cure failures to do so” (Para. 51). Thus, Buckingham’s attempts to sell the company to pay the GST debt did not constitute due diligence.

This is a welcome conclusion, as the previous case law was conflicting. The Tax Court disregarded “after the fact” repair attempts. However, in other cases, the Tax Court gave substantial weight to the work done to try to remedy the company’s failure to remit.

In Jarrold, [2010] GSTC 158, the Court of Appeal seemed to suggest that “after-the-fact” attempts to repair the damage were legally relevant. Those comments should be considered obiter and incorrect in my view, in light of the clear ruling in Buckingham.

Finally, the Court of Appeal did not address a jurisdictional issue that was raised by the Tax Court. The Tax Court ruled that any appeal relating to source deductions of provincial tax (under the New Brunswick Income Tax Act) would have to be taken to the provincial court. This principle is well established with respect to provincial tax credits (e.g. Gardner, [2002] 1 CTC 302 (FCA)), but to my knowledge was not previously raised in a directors’ liability appeal. The Tax Court’s conclusion, which it repeated in Seier, [2010] GSTC 146, appears to be correct. If the Tax Court indeed has no jurisdiction to rule on liability for provincial source deductions, directors will have to launch a multiplicity of appeals in different courts to protect their interests. Perhaps it would be better for the CRA to continue to ignore this issue and accept that an appeal of source deductions liability applies in practice to all source deductions liability. I have raised the issue with the Tax Court Bench and Bar Committee for review.

Car used primarily personally by shareholder

9180-2801 Quebec Inc. v. R., [2011] GSTC 37 (Tax Court of Canada (Informal Procedure))

This was a case of an input tax credit (ITC) on a car. The ITC was denied, but, with respect, should have been allowed.

The appellant company bought a car, which was driven by its shareholder partly on company business and partly for personal purposes. It claimed an ITC on the purchase. Subsec. 199(2) permits an ITC on the acquisition of capital property only if the property is purchased “primarily” for use in commercial activities.

Revenu Quebec (RQ), which administers the GST in Quebec, denied the ITC on the basis that the shareholder’s use of the car was more than 50% personal. The company appealed to the Tax Court of Canada.

Justice Lucie Lamarre dismissed the appeal. On the evidence, the car was used slightly more than 50% for personal purposes over the course of the year. As well, the use in the months after it was first purchased was mostly personal, suggesting that the intention when the car was purchased was personal. Therefore, the condition in Subsec. 199(2) was not met.

With respect, the Court overlooked Para. 173(1)(c), which provides that where a company makes property available to an employee or shareholder as a taxable benefit – which was the case here – the use of the property by the employee or shareholder is deemed to be use in commercial activities of the company. The GST is dealt with not by denying the company an ITC, but by imposing GST under Sec. 173 on the taxable benefit. Only if the use is “exclusively” (substantially all) for the employee does Para. 170(1)(b) deny an ITC.

Thus, the ITC should have been allowed. If GST was assessed on the taxable benefit as well, then there has been double tax.

Mixed-used passenger vehicle

Nelson v. R., [2011] GSTC 72 (Tax Court of Canada (Informal Procedure))

This was a creative but doomed attempt to stretch the GST legislation applying to automobiles to reach a new interpretation of “substantially all”.

Mr and Mrs Nelson were in business as farmers. They bought a vehicle (probably a pickup truck or minivan) for use in their farming business, and used it 54% for business purposes and 46% for personal purposes. The vehicle cost CAD 50,000, and fell into the definition of “passenger vehicle” for GST purposes. For purposes of claiming input tax credits (ITCs), the cost of such a vehicle is limited to CAD 30,000 by Sec. 201. The Nelsons claimed an ITC of CAD 1,500, which was 5% of CAD 30,000, on their purchase of the truck. The CRA denied the ITC on the basis that they did not use the truck “substantially all” in commercial activities, as required by Subsec. 202(2). The Nelsons appealed to the Tax Court of Canada.

Justice Judith Woods dismissed the appeal. The business use of 54% was not “substantially all”, and that was the end of the matter.

The Nelsons argued that their 54% business use of the vehicle was 90% of the 60% of the vehicle that was allowed for GST purposes. Not surprisingly, the Court did not buy this argument. The fact that only 60% of the vehicle’s cost was allowed for GST purposes did not somehow boost the Nelsons’ use of the vehicle to the level of “substantially all”.

The Court’s decision is clearly correct, in my view. The CAD 30,000 limit is unrelated to the “substantially all in commercial activity” calculation, and each restriction applies independently.

David M. Sherman
www.davidsherman.ca

France

Zero rating intra-Community supplies

By its decision of 25 February 2011 in Société Abacus Equipement Electronique, Case No. 312290, the Conseil d’Etat (Supreme Court) ruled that, in the absence of indications of fraud, the tax authorities cannot refuse the application of the zero rate to intra-Community supplies of goods on the mere ground that the supplier has not checked the validity of the customer’s VAT identification number in the appropriate database (VAT Information Exchange System, VIES).

In this respect, the Conseil d’Etat, observing that there is no legal obligation on suppliers to consult the VIES, reversed the decision of the Cour Administrative d’Appel de Douai (Administrative Appeal Court Douai) that decided that VAT on expenses paid by a business incubator* on behalf of, and for the purposes of starting up, a company can be recovered by the start-up company, even if the related invoices are addressed to the business incubator, provided that those invoices have been approved by the start-up company and are included in its business records.

From our correspondents Elvire Tardivon-Lorizon and Xavier Casal
Marcus Partners SELAS affiliated to Marzars, Paris

Private use of business cars

Taxable persons who use a passenger car, which forms part of their business assets, for both business and private purposes must initially deduct the full amount of VAT on the purchase or lease of the vehicle and on the operating expenses (fuel, repairs, maintenance, etc.) and, then, annually adjust the initial deduction for private use of the vehicle. The annual adjustment consists of the liability to pay to the tax authorities 12% of the amount that is considered to reflect the value of the private use of the car for income tax purposes. Since the income tax adjustment for private use of business cars is based on the catalogue price of the car, the percentage of 12 takes into account that most car expenses bear VAT at the standard VAT rate of 19%, whereas other expenses (taxes and insurance) do not bear VAT. For income tax purposes, the annual adjustment for private use of business cars is set at a flat rate of 25% of the catalogue price of the passenger car. However, in order to encourage the use of low-fuel-consumption and “environment-friendly” vehicles, the legislator has reduced the flat-rate adjustment percentage for private use of specific categories of business cars to 14. With effect from 2010, the reduced percentages are 14 and even 0 (for electrically propelled vehicles).

8. Business incubators are programmes designed to ensure the successful development of entrepreneurial companies through an array of business support resources and services, developed and orchestrated by incubator management and offered both in the incubator and through its network of contacts. Incubators vary in the way they provide their services, in their organizational structure, and in the types of customers they serve. Successful completion of a business incubation programme increases the likelihood that a start-up company will stay in business for the long term.
VAT relating to business cars used by employees for both business and private purposes must in principle be split up into a deductible and non-deductible part, based on actual use of the vehicle. However, the State Secretary for Finance has accepted in a public notice that, in this respect, business cars used by employees are treated on the same footing with business cars used by taxable persons.

By its decision of 1 June 2011, No. AWD 09/3866, the Rechtbank (Court of first instance) Haarlem declared that the principle of equal treatment requires that equal situations are treated equally and that, for the purposes of adjusting initial full deduction of VAT in respect of mixed-used cars, environment-friendly and environment-unfriendly cars are equal situations because, for adjustment purposes, only the total amount of input VAT and the degree of private use of the vehicle are relevant. The Rechtbank observed that the amount of input VAT is fixed and that there is no reason to assume that environment-friendly cars are used to a lesser extent for private purposes than environment-unfriendly vehicles.

The distinction between environment-friendly and environment-unfriendly cars is therefore not based on VAT considerations (taxation of private use of vehicles) but on environmental goals, which are irrelevant for VAT purposes. The Rechtbank rejected the contention of the tax authorities that making a distinction between environment-friendly and environment-unfriendly vehicles can be justified on ponderous social, economic and political motives relating to the protection of the environment. According to the Rechtbank, environmental considerations are irrelevant in the context of adjusting the right to deduct VAT for private use.

On those grounds, the Rechtbank concluded that the appellant could adjust the initial full deduction of VAT in respect of his environment-unfriendly car on the basis of the lower percentage applicable to environment-friendly cars.

The tax authorities will appeal against the Rechtbank’s decision.

However, the Ministry of Finance will not await the results of the appeal and announced on 17 June 2011 that it will change the rules with effect from 1 July 2011.

From that date and regardless of whether a business car is used for free by a taxable person or employee, initial full deduction of the VAT on car-related expenses is adjusted for private use, including commuting between home and working place, on the basis of a deemed service, which corresponds with actual private use of the car. In order to prevent that taxable persons and employees have to keep records of distances travelled for business and private purposes, the tax authorities will accept that, although the current link between VAT and income tax adjustments will be broken, adjustment of the initial full input VAT deduction is based on a flat-rate percentage (2.7%) of the catalogue price of the car, which should reflect average private use of business cars.

**Security deposits**

Under the tax legislation, VAT becomes chargeable on the earlier of:

- the date of delivery of goods (work, services) or transfer of property rights;
- the date of receipt of the payment or partial payment for future supplies of goods (work, services), or transfers of property rights.

However, the tax legislation does not contain any rules with respect to the question of whether or not receipt of a security deposit under a provisional contract gives rise to a VAT liability on the part of the party that received the deposit.

By its Resolution No. A12-16130/2010 of 24 March 2011, which did not become publicly available until April 2011, the Federal Arbitration Court of the Povolzhsky district ruled that a security deposit received under a provisional contract gives rise to a VAT liability on the part of the party that received the deposit.

From our correspondent Oleg Berezin
Deloitte, Russia

**Sale of shares**

A real estate broker had asked the Skatterättsnämnden (Board for Advance Tax Rulings) whether its intermediary services relating to the transfer of real estate, which had been packaged into a limited company, were subject to VAT as intermediary services relating to the transfer of real estate, or exempt from VAT as intermediary services relating to the transfer of shares.

The Skatterättsnämnden ruled that the services of the real estate broker were the same, regardless of whether, for VAT purposes, the services are qualified as intermediary services relating to the transfer of real estate or of shares. In essence, the main transaction concerned the transfer of a real estate and, therefore, the real estate broker’s intermediary services were subject to VAT.

By its decision of 27 April 2011, No. 3869-10, the Högsta förvaltningsdomstolen (Supreme Administrative Court) reversed the Skatterättsnämnden’s advance ruling and declared that the services supplied by the real estate broker were exempt as intermediary services relating to the transfer of shares.

**Underwriting guarantee**

By its decision of 25 May 2011, No. 1267-09, the Högsta förvaltningsdomstolen reversed its previous position, as reflected in a decision of 2003, and decided, on the basis of the answer of the ECJ to its request for a preliminary
ruling,9 that the services supplied for consideration by a credit institution, Skandinaviska Enskilda Banken AB Momsgrupp, in the form of giving an underwriting guarantee to a company wishing to issue shares, are exempt from VAT, where, under that guarantee, the credit institution undertakes to acquire any shares which are not subscribed within the period for share subscription.

Intra-Community acquisition of new means of transport

By its decision of 30 May 2011, No. 2666-08, the Högsta förvaltningsdomstolen decided the dispute between X and Skatteverket (tax authorities) in line with the answers of the ECJ to its request for a preliminary ruling.10 The Högsta förvaltningsdomstolen found that the private person, X, who had purchased a new sailing boat in the United Kingdom, had to pay Swedish VAT on the intra-Community acquisition of the new boat, even though, at the time the boat arrived in Sweden, it no longer qualified as a “new vessel”. The assessment of whether a means of transport is “new” must be made at the time of the supply of the goods in question, not at the time the means of transport reaches the final destination as intended by the purchaser at the time he purchased the boat.

From our correspondent Tomas Karlsson
Ernst & Young AB, Stockholm

Sporting services

Under UK law, sporting services provided by eligible bodies are exempt from VAT. However, where the body has a membership scheme, the exemption only applies to services to members. Therefore, visitors that wish to play golf at a members’ (non-profit-making) club are charged VAT on the “green fees” that they pay.

The First Tier Tribunal decided these fees must not bear VAT, as the visitors receive the same services as members, i.e. the right to play golf, and so the principle of tax neutrality requires that the services are treated in the same manner.

The tax authorities (Her Majesty’s Revenue and Customs, HMRC) had argued that the green fees were additional income for the club derived from supplies in respect of which it was competing with commercial (profit-making) clubs, which have to charge VAT to both visitors and members wishing to play golf. Therefore, Art. 134(b)11 of the VAT Directive prohibited exemption. However, the Tribunal did not view these fees as additional income, since they comprised a significant proportion of the club’s regular income and the income was used to meet day-to-day running costs.

It is not yet known whether HMRC will appeal.

Decision of the First Tier Tribunal of 1 June 2011 in Bridport and West Dorset Golf Club v. Her Majesty’s Revenue and Customs, FTT TC01214.

Lease of building

The Gateshead Talmudical College had granted a lease in a building to a tenant under the option for taxation and, then, leased the building back. After two years, the tenant stopped paying rent and was struck off but the lease continued. The College did not declare any output tax once the tenant stopped paying the rent and HMRC required the College to adjust, under the capital-goods scheme, the input VAT that the college had initially deducted on the ground that the use of the building had changed. The College argued that the taxed lease continued in law, so there was no change of use. The circumstance that the value of the taxable supplies had been reduced to zero was irrelevant in that respect.

Just like the First Tier Tribunal did in June 2010, the Upper Tier Tribunal found for HMRC, on the grounds that the taxable supplies had decreased to nil and the College occupied the building for the purposes of its exempt educational activities.

It is interesting to speculate on the outcome of the proceedings, if the College had continued to account for VAT on the lease and, then, had claimed bad-debt relief on the unpaid rent.


From our correspondent Karen Killington
KPMG UK LLP

10. ECJ judgment of 18 November 2010 in X v. Skatteverket, Case C-84/09.
11. Art. 134 of the VAT Directive provides that the supply [...] of services shall not be granted exemption, as provided for in point [...] (m) [...] of Art. 132(1), in the following cases: [...] (b) where the basic purpose of the supply is to obtain additional income for the body in question through transactions which are in direct competition with those of commercial enterprises subject to VAT.

Annex III to the VAT Directive contains a limited list of supplies of goods and services that may be subject to a reduced VAT rate. Included in that list are foodstuffs for human and animal consumption, as well as live animals, seeds, plants and ingredients normally intended for use in the preparation of foodstuffs (point 1), and agricultural inputs (point 11).

As regards the Commission’s contention, the ECJ observed that point 1 of Annex III of the VAT Directive authorizes the application of a reduced rate of VAT only in respect of live animals normally intended for use in the preparation of foodstuffs. The use of the adverb “normally” is intended to limit the reduced rate to animals which, usually and in general, enter into the human and animal food chain, which is not the case for all horses. Consequently, only the supply of horses for slaughter to be used in the preparation of foodstuffs may be subject to a reduced VAT rate.

In this framework, the ECJ rejected the argument of the German government that the application of a reduced rate can be based on Art. 20 of Regulation No. 504/2008 on the ground that Regulation intends to ensure that a horse which enters into the human food chain is not unfit for consumption. However, it is not possible to determine, on the basis of EU legislation, whether a horse is finally used for consumption.

The ECJ also held that general application of a reduced VAT rate to horses cannot be based on the principle of neutrality because horses destined for slaughter are not similar to racehorses or pet horses. Those categories of horses are not in competition, which means that they can be subject to different VAT rates.

Finally, application of a reduced VAT rate to horses cannot be based on point 11 of Annex III because, in EU Member States, horses are not used, usually and in general, in agricultural production.

On those grounds, the ECJ (Seventh Chamber) declared on 12 May 2011 that:

“By applying a reduced VAT rate to the supply, importation and intra-Community acquisition of all horses, Austria and Germany have failed to fulfill their obligations under Arts. 96 and 98 of the VAT Directive, read in conjunction with Annex III thereto.”

Judgments of 12 May 2011: Case C-107/10 Enel Maritsa Iztok 3 AD v. Direktor 'Obzhalvane i upravlenie na izpalnenieto' NAP

On 11 October 2007, Enel submitted a VAT return which showed an amount of excess input VAT of BGL 2.3 million. Since Enel had not been in a position to deduct the tax during the three preceding tax periods, the tax should have been refunded under national law within 45 days, i.e. on 26 November 2007.

On 8 November 2007, the tax authorities announced a tax investigation with a view to establishing Enel’s VAT liabilities for the period from 1 January 2005 to 30 September 2007 and liabilities for other taxes for 2005 and 2006. By notice of refund of 19 December 2007, the tax authorities refunded the sum of BGL 1.4 million, which was transferred to Enel’s account on 21 December 2007.


2. Commission Regulation (EC) No. 504/2008 of 6 June 2008 implementing Council Directives 90/426/EEC and 90/427/EEC as regards methods for the identification of equine animals. One of the criteria has been replaced by “European Union”, unless that term forms part of legally defined concepts, such as in “intra-Community acquisition”.

3. The ECJ’s judgments in the infringement procedures against Austria and Germany are materially identical to its judgment in the infringement procedure of the Commission against the Netherlands. See ECJ judgment of 3 March 2011 in European Commission v. Kingdom of the Netherlands, Case C-41/09, International VAT Monitor 3 (2011), p. 209.
claimed default interest on the total VAT refund for the period between 26 November 2007 and the date on which the amounts were actually repaid.

Under Art. 92 of the VAT Act, excess input VAT must first be carried forward to the next three tax periods and the remaining balance must then be refunded within 45 days from the date of submission of the third return. In respect of tax that has not been refunded within the legally prescribed period, regardless of the suspension of the refund period, the tax authorities must pay default interest from the date on which the tax should have been refunded until it is paid in full.

Until 18 December 2007, Art. 93(1)(5) provided that, in the event of a tax investigation, the refund period was suspended until the investigation was completed.

With effect from 19 December 2007, Art. 93(1)(5) was deleted and Art. 92(8) provides that, in the event of a tax investigation, the deadline for refunding VAT expires at the time the tax assessment notice must be issued, unless the beneficiary provides security in the form of money, government bonds or a bank guarantee.

Art. 183 of the VAT Directive provides that, where the amount of deductions for a given tax period exceeds the amount of VAT due, the Member States may, in accordance with conditions which they shall determine, either make a refund or carry the excess forward to the following period.

As regards the questions of the Administrative Court of Sofia (Administrative Court, Sofia) of whether Art. 183 of the VAT Directive is to be interpreted as precluding national legislation under which:

- the period within which excess input VAT must be refunded is extended with retrospective effect,
- where a tax investigation has been instigated, the refund period, which is usually 45 days, is extended, which has the effect that interest is payable only from the date on which the investigation is completed; and
- excess input VAT is refunded by means of set-off against other tax liabilities,

the ECJ observed that it is perfectly permissible that new rules apply to the future consequences of situations which arose under the earlier rules. However, a legislative amendment retroactively depriving a taxable person of a right he has derived from earlier legislation is incompatible with the principle of the protection of legitimate expectations.

As a general rule, the period for refunding excess input VAT may be extended in order to carry out a tax investigation, provided that the extension does not go beyond what is necessary for the successful completion of the investigation. However, in so far as the taxable person is deprived on a temporary basis of funds corresponding to the excess VAT, he is at an economic disadvantage which can be compensated for by payment of interest, thus ensuring compliance with the principle of tax neutrality. In this case, the combination of carrying forward excess input VAT and extending the refund period until completion of a tax investigation does not only have the effect of depriving the taxable person for a considerable period, namely approximately eight months, of funds corresponding to the excess input VAT but also of depriving that person of the right to receive interest that is normally payable. In addition, the national legislation empowers the tax authorities to instigate a tax investigation at any time, even at a date close to that on which a refund period expires, thus making it possible to extend considerably the refund period and, at the same time, to defer the date from which default interest is payable on the sum to be refunded.

Set-off results in the two mutual obligations being extinguished in whole or in part, thus enabling the Member State to discharge its refund obligation.

On those grounds, the Third Chamber of the ECJ declared on 12 May 2011 that:

“(1) Art. 183 of Directive 2006/112, as amended by Directive 2006/138, in conjunction with the principle of the protection of legitimate expectations, is to be interpreted as precluding national legislation which provides, with retrospective effect, for the extension of the period within which excess [input] VAT is to be refunded, in so far as that legislation deprives the taxable person of the right enjoyed before the entry into force of the legislation to obtain default interest on the sum to be refunded.

(2) Art. 183 of Directive 2006/112, as amended by Directive 2006/138, in the light of the principle of fiscal neutrality, is to be interpreted as precluding national legislation under which the normal period for refunding excess [input] VAT, at the expiry of which default interest is payable on the sum to be refunded, is extended where a tax investigation is instigated, the effect of the extension being that such interest is payable only from the date on which the investigation is completed, the excess [input VAT] having already been carried forward during the three tax periods following that in which it arose. On the other hand, the fact that the normal period is 45 days is not contrary to that provision.

(3) Art. 183 of Directive 2006/112, as amended by Directive 2006/138, is to be interpreted as not precluding the refund of excess [input] VAT by way of set-off.”

Judgment of 9 June 2011: Case C-285/10 Campsa Estaciones de Servicio SA v. Administración del Estado

On 31 December 1993, Campsa sold Repsol Combustibles Petrolíferos SA a number of service stations located in Spain for a price which was patently below the open-market value of the service stations. Campsa and Repsol were connected parties. On 7 July 1998, the tax authorities corrected Campsa’s VAT return for the year 1993 increasing the taxable amount for the transaction in accordance with the open-market value of the service stations.

4. Editors’ note: if the VAT authorities charged default interest on the assessment of the other taxes that Enel had underpaid for 2005 and 2006, payment of default interest by the tax authorities on the amount of BGL 180,000, which was on balance refunded to Enel, was obviously incorrect.
Art. 11(A)(1)(a) of the Sixth Directive provided that the taxable amount is everything which constitutes the consideration which has been or is to be obtained by the supplier from the purchaser, unless the transaction concerns the use by a taxable person for his private purposes of goods and services that belong to his business.

Art. 27(1) of the Sixth Directive provided that the Council may authorize Member States to deviate from the provisions of that Directive, and Art. 27(5) provided that Member States that applied a special measure on 1 January 1977 were allowed to retain that derogation if they had notified the Commission before 1 January 1978.

On 15 May 2006, the EU Council authorized Spain to apply the open-market price to transactions between connected parties if the agreed consideration is significantly lower than the open-market value of the supply.

Art. 79(5) of the Spanish VAT Law of 1992 provided that the price for taxable transactions between connected parties cannot be lower than the open-market price. A similar provision had existed in the Spanish VAT Law since the date of Spain’s accession to the European Union (1 January 1986).

As regards the question of the Tribunale Supremo (Spanish Supreme Court) of whether Spain could apply the open-market price to the supply made by Campsa in 1993, the ECJ held that, where a consideration has been agreed and actually paid in direct exchange for goods delivered or services provided, that transaction must be classified as a transaction for consideration, regardless of whether it is effected between connected parties and the price agreed and actually paid is patently lower than the open-market price. In such a case, the taxable amount for the transaction is the subjective price, and not an estimated price based on objective criteria, such as the taxable amount that applies in the event of application by a taxable person of goods and services for private use.

Member States can only deviate from the subjective price if they are authorized to that effect under Art. 27 of the Sixth Directive. In this respect, the ECJ observed that, unless the Act of Accession provides otherwise, references to dates laid down in EU law also apply to acceding states, even if those dates are prior to the date of their accession. Therefore, at the time Campsa made the supply (31 December 1993), Art. 79(5) of the Spanish VAT Law could neither be lawfully based on Art. 27(5) of the Sixth Directive (because 1 January 1977 is prior to 1 January 1986), nor on Art. 27(1) of the Directive (because the Council granted Spain authorization to apply the open-market price on 15 May 2006).

As the supply was made in 1993, it was irrelevant that the Sixth Directive had been amended to the effect of authorizing all Member States to apply the open-market price because the amending Directive 2006/69 of 24 July 2006 entered into force on 13 August 2006, i.e. after the date of Campsa’s supply.

On those grounds, the ECJ (Eighth Chamber) declared on 9 June 2011 that: “The Sixth Directive must be interpreted as precluding a Member State from applying to transactions, such as those in the main proceedings, effected between connected parties having agreed a price which is patently lower than the open market price, a rule for determining the taxable amount other than the general rule laid down in Art. 11(A)(1)(a) of that Directive, by extending the scope of the rules for determining the taxable amount on the application of goods and services for private use by a taxable person, within the meaning of Arts. 5(6) and 6(2) of that Directive, when the procedure provided for in Art. 27 of that Directive to obtain authorization for such derogation from that general rule has not been followed by that Member State.”

Order of 15 April 2011: Case C-613/10 Danilo DeBiasi v. Agenzia delle Entrate, Ufficio di Parma

In its order for reference of 7 July 2010, the Commissione tributaria provinciale di Parma (Italy) (“referring court”) mentioned that, under Art. 19(2) of DPR No. 633/1972 (“VAT Act”), VAT on the purchase or importation of goods and services is non-deductible if the goods and services are used for the purposes of carrying out transactions that are exempt from VAT or outside the scope of VAT, whereas Art. 19(1) of the VAT provides that VAT on the purchase of goods and services used by companies for business purposes is deductible. In this respect, the referring court noted that Art. 19(2) seems unlawful and contrary to Art. 19(1) because it is settled case law that medical services are business activities within the scope of VAT and constitute transactions in respect of which input VAT is deductible under the Sixth Directive. In this context, the referring court observed that, under Art. 13(B)(c) of the Sixth Directive, supplies of goods used wholly for an activity that is exempt from VAT are exempt from VAT when these goods have not given rise to the right to deduct.

As regards the questions of the Commissione tributaria provinciale di Parma of whether: – there is a conflict between the right to deduct input VAT under, on the one hand, the VAT Act and, on the other hand, the Sixth Directive and the documents COM(2001) 260 of 23 May 2001 and COM(2000) 348 of 07 June 2000; and

– there is also unequal treatment of the VAT rules at Community level and, consequently, a need of harmonization with the other European systems, given that various Member States apply, subject to certain conditions, a system of taxation at a reduced rate, the ECJ observed that, under the procedure for preliminary rulings laid down by Art. 267 TFEU, the ECJ provides national courts with its interpretation of EU law if that is necessary for the solution of disputes by the...
national courts. To that end, it is for the national court, which is the only instance that has direct knowledge of the relevant facts and which is responsible for the decision to refer questions to the ECJ, to provide the latter with all information as regards the factual and legal framework on which the questions are based, in order to enable the ECJ to give a useful answer. The essential information must be contained in the order for reference in order to enable the governments of Member States and other interested parties to present their observations to the ECJ.

In this case, the order for reference clearly did not fulfil those requirements. The order only indicated that the questions had arisen in the context of an appeal of an individual against refusal of the tax authorities to refund VAT relating to the year 2006. Furthermore, the referring court had not provided sufficiently detailed information on the national legal framework to enable interested parties to present their observations and to enable the ECJ to give a useful answer. In particular, where it referred to relevant national legal provisions, the referring court limited itself to providing concise summaries of those provisions, which makes it impossible to establish their precise contents. Finally, the referring court has not at all explained the precise reasons for its view that interpretation of EU law is necessary to resolve the dispute in the main proceedings, and the order for reference did not make it possible to establish with certainty precisely what provisions of EU law the referring court requested the ECJ to interpret.

On those grounds, the ECJ (Seventh Chamber) declared by Order of 15 April 2011 that:

“The request for a preliminary ruling made by the Commissione tributaria provinciale di Parma (Italy) by its order of 7 July 2010 is manifestly inadmissible.”

Opinions

Opinion of 28 June 2011: Case C-218/10 ADV Allround Vermittlungs AG, in liquidation v. Finanzamt Hamburg-Bergedorf

ADV’s business in 2005 consisted in the supply of self-employed lorry drivers, under agency agreements with the drivers, to haulage contractors in Germany and abroad, in particular in Italy. The drivers charged ADV for their work, which consisted in driving the lorries provided by the haulage contractors, while ADV charged the latter for the supply of the drivers.

ADV initially did not charge VAT to clients located outside Germany, assuming that the service in question constituted a “supply of staff” and, consequently, that the place of supply and of taxation was at the place where the customer was established (in Italy).

However, the tax office Hamburg-Bergedorf expressed in 2006 the view that “supply of staff” covered only the making available of a company’s own workers (labour leasing) and that, accordingly, the place of supply was the place from which ADV conducted its business, i.e. Germany.

Thereupon, ADV started to charge German VAT to its Italian customers. In addition, it drew up amended invoices showing German VAT in respect of the services supplied in 2005, assuming that the German VAT would be refunded to the Italian customers.

However, the Bundessozentralamt für Steuern (Federal Central Tax Office), responsible for VAT refunds, held that the notion of “supply of staff” also covered supplies of drivers such as those at issue here. Accordingly, the German VAT had incorrectly been entered on the amended invoices and could not be refunded.

Under Art. 9(2)(e) of the Sixth Directive (Art. 56(1)(f) of the VAT Directive, version in force until 31 December 2009), the place where the supply of staff was made for taxable persons established in another Member State was the place where the customer had established his business.

As regards the questions of the Finanzgericht Hamburg (Germany) of:

- whether or not, under the Sixth Directive, the term “supply of staff” also covers the supply of self-employed persons not in the employ of the provider of that service; and
- whether the Sixth Directive requires that provision must be made to ensure that the taxability and liability to tax of one and the same service are assessed in the same way in relation to the trader providing the service and the trader receiving it, even where the two traders fall within the jurisdiction of different tax authorities,

AG Mazák delivered his Opinion on 28 June 2011. He proposed that the ECJ should declare that:

“(1) Art. 9(2)(e) of Sixth Directive must be interpreted as meaning that “supply of staff” also includes the supply of self-employed persons not in the employ of the provider of that service; and
(2) the Sixth Directive, and its provisions on the right to deduct in particular, do not require that particular provision must be made in national procedural law to ensure that, in circumstances such as those of the present case, the taxability and liability to tax of one and the same service are assessed in the same way in relation to the trader providing the service and the trader receiving it, even where the two traders fall within the jurisdiction of different tax authorities.”

Opinion of 26 May 2011: Case C-274/10 European Commission v. Republic of Hungary

Art. 168(a) of the VAT Directive provides that, in so far as the goods and services are used for the purposes of the taxed transactions, taxable persons are entitled to deduct the VAT due or paid in respect of supplies to him of goods or services.

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8. Editors’ note: the position that ADV’s services cannot be classified as the “supply of staff” is very plausible. However, since it acted as an agent, ADV’s intermediary services would still be taxable at the place where its non-resident customers are registered (in Italy), under Art. 28(b)(3) of the Sixth Directive (Art. 44 of the VAT Directive, text until 31 December 2009).
Art. 183 of the VAT Directive provides that, where, for a given tax period, the amount of deductions exceeds the amount of VAT due, the Member States may, in accordance with conditions which they shall determine, either make a refund or carry the excess forward to the following period.

The Commission sought a declaration that by:
- requiring taxable persons whose VAT return for a given tax period records excess input tax to carry forward that excess, or a part of it, to the following tax year where the taxable person has not paid the supplier the full amount for the purchase in question; and
- by creating a situation, as a result of that requirement, where certain taxable persons whose VAT returns regularly record such excess input tax may be required more than once to carry forward the excess to the following tax year, Hungary has failed to fulfil its obligations under the VAT Directive.

Editors' note: In this respect, it should be noted that the expression "tax year" used in the English version of the announcement of the case is obviously incorrect. The French version of the announcement uses the expression "période imposable" (tax period).

On 26 May 2011, AG Bot delivered his Opinion relating to the infringement procedure. The AG concluded that the ECJ should declare that, as claimed by the Commission, Hungary has failed to fulfil its obligations under the VAT Directive by requiring that:
- taxable persons, whose VAT return for a specific tax period records excess input tax, must carry the excess forward to the following tax period, if they have not paid their supplier in full for the supply (the AG observed that Art. 168(a) of the Directive does not require that, for deduction purposes, the tax must have been paid); and
- on the basis of the obligation under the first indent, specific taxable persons, whose VAT returns regularly show excess input tax, must carry the excess forward to the following tax period more than once.

[Unofficial translation]

Editors' note: The AG obviously overlooked that, two weeks before he delivered his Opinion, the ECJ observed in its judgment in Enel Maritsa11 that Art. 92 of the Bulgarian VAT Act, under which excess input VAT must first be carried forward to the next three (monthly) tax periods and must then be refunded within 45 days from the date of submission of the third return, is consistent with the freedom enjoyed by Member States in determining the conditions for refunding excess input VAT. According to the ECJ, the fact that the excess input tax is carried forward to the three monthly tax periods following that in which the excess in question arose does not, in itself, affect the principles of equivalence and effectiveness, the principle of the protection of legitimate expectations, the right of taxable persons to deduct the VAT they have paid on inputs from the VAT which they are liable to pay, the principle that the right to deduct is an integral part of the VAT scheme and, as a general rule, may not be limited, the principle that the right to deduct is exercisable immediately in respect of all the taxes charged on inputs, or the principle of fiscal neutrality.

The AG did not base his opinion on the principle of tax neutrality or any other principle of EU law but on the literal text of Art. 183 of the VAT Directive, i.e. Member States have two options only: refund the excess input tax or carry it forward to "the next tax period" (singular). However, the ECJ explicitly rejected that interpretation in Enel Maritsa.12

The AG’s conclusions will nonetheless produce a correct result in the case of quarterly or annual VAT returns but definitely not in the case of monthly VAT returns. Hopefully, the ECJ will notice that its Advocate General did not notice the ECJ’s recent judgment.

New Cases

Preliminary ruling: Case C-44/11 Finanzamt Frankfurt am Main V—Hochst v. Deutsche Bank AG

By its order of 31 January 2011, the Bundesfinanzhof (Germany) has referred the following questions to the ECJ for a preliminary ruling:

“(1) Is the management of securities-based assets (portfolio management), where a taxable person determines for remuneration the purchase and sale of securities and implements that determination by buying and selling the securities, exempt from tax:
- only in so far as it consists in the management of investment funds for a number of investors collectively within the meaning of Art. 135(g) of Directive 2006/112; or also
- in so far as it consists in individual portfolio management for individual investors within the meaning of Art. 135(1)(f) of Directive 2006/112 (transactions in securities or the negotiation of such transactions)?

(2) For the purposes of defining principal and ancillary services, what significance is to be attached to the criterion that the ancillary service does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied, in the context

9. In Hungary, VAT returns must be filed on a monthly, quarterly or annual basis. Several Member States require that excess input tax must be carried forward from one tax period to the following, until the end of the year. Therefore, it was not immediately obvious that the English version of the announcement was incorrect.

10. In its judgment of 29 April 2004 in Terra Baudedarf-Handel GmbH v. Finanzamt Osterholz-Scharmbeck, Case C-152/02, [2004] ECR I-5583, the ECJ declared that, for the deduction referred to in Art. 17(2a) of the Sixth Directive, the first subparagraph of Art. 18(2) of the Sixth Directive must be interpreted as meaning that the right to deduct must be exercised in respect of the tax paid in which the two conditions required by that provision are satisfied, namely that the goods have been delivered or the services performed and that the taxable person holds the invoice or the document which, under the criteria determined by the Member State in question, may be considered to serve as an invoice.


12. Id, Paras. 48 and 49.
of separate invoicing for the ancillary service and the fact that the ancillary service can be provided by third parties?

(3) Does Art. 56(1)(e) of Directive 2006/112 cover only the services referred to in Art. 135(1)(a) to (g) of Directive 2006/112 or also the management of securities-based assets (portfolio management), even if that transaction is not subject to the latter provision?

Preliminary ruling: Case C-69/11 Connoisseur Belgium BVBA v. Belgische Staat

By its order of 16 February 2011, the Rechtbank van eerste aanleg te Brugge (Belgium) has referred the following question to the ECJ for a preliminary ruling:

“Does Art. 26 of the Wetboek van de BTW (the Belgian VAT Code) infringe Art. 11(A)(1)(a) of the Sixth Directive, now incorporated in Art. 73 of Directive 2006/112, and the principle of the neutrality of VAT, if that provision is interpreted as meaning that VAT is due on costs or amounts which could contractually be charged to the other contracting party but which are not so charged?”

Preliminary ruling: Case C-80/11 Mahagében Kft v. Nemzeti Ádó és Vámhivatal Dél-dunántúli Regionális Ádó Főigazgatósága

By its order of 22 February 2011, the Baranya Megyei Bíróság (Hungary) has referred the following questions to the ECJ for a preliminary ruling:

“(1) Must Directive 2006/112 be interpreted as meaning that a taxable person who fulfills the material conditions for the right to deduct VAT in accordance with the provisions of that Directive may be deprived of his right to deduct by national legislation or practice that prohibits deductions in respect of VAT paid when a product is bought, where the invoice is the only valid document that confirms that the product was sold, and the taxable person is not in possession of any document from the issuer of the invoice which certifies that he was in possession of the product, and could have supplied it or satisfied his obligations as regards declaration? May a Member State require the recipient of the invoice to be in possession of a document proving that he is in possession of the product, or that the product was supplied or delivered to it, to ensure the correct collection of VAT and to prevent evasion under Art. 273 of the Directive?

(2) Is the concept of due diligence set out in Para. 44(5) of the Hungarian Law on VAT compatible with the principles of neutrality and proportionality already upheld several times by the ECJ in connection with the application of the Directive if, in applying that concept, the tax authority and established case law require the recipient of the invoice to ascertain whether the issuer of the invoice is a taxable person, whether he has entered goods purchased in his records and is in possession of the purchase invoice, and whether he has satisfied his obligations as to declaration and payment of VAT?

(3) Must Arts. 167 and 178(a) of Directive 2006/112 be interpreted as meaning that they preclude national legislation or practice that requires a taxable person receiving an invoice to verify compliance with the law by the company issuing the invoice in order for the former to assert his right to deduct?”

Action: Case C-85/11 European Commission v. Ireland, Case C-86/11 European Commission v. United Kingdom of Great Britain and Northern Ireland, Case C-95/11 European Commission v. Kingdom of Denmark and Case C-109/11 European Commission v. Czech Republic

On 24 February 2011, the Commission of the European Union brought an action against Ireland and the United Kingdom of Great Britain and Northern Ireland before the ECJ. On 28 February 2011, the Commission brought an action against the Kingdom of Denmark, and on 3 March 2011 an action against the Czech Republic before the ECJ.13

The Commission claimed that the ECJ should declare that, by allowing non-taxable persons to be part of a VAT group, Ireland, the United Kingdom, the Kingdom of Denmark and the Czech Republic have failed to fulfil their obligations under Directive 2006/112.

Pleas in law and main arguments

In order to simplify administration and prevent certain forms of abuse, the VAT Directive allows Member States to regard two or more taxable persons as a single taxable person. The Commission takes the view that the Directive does not allow non-taxable persons to be part of such a VAT group and thereby be covered by the rights and obligations which apply to taxable persons. Therefore, the Irish, UK, Danish and Czech legislations, which allow non-taxable persons to be part of a VAT group, are not compatible with the Directive.

Action: Case C-108/11 European Commission v. Ireland

On 2 March 2011, the Commission of the European Union brought an action against Ireland before the ECJ.14

The Commission claimed that the ECJ should declare that, by applying a VAT rate of 4.8% to supplies of greyhounds and horses not normally intended for the preparation of foodstuffs, to the hire of horses and to certain insemination services, Ireland has failed to comply with its obligations under Arts. 96, 98 (in conjunction with Annex III) and 110 of Directive 2006/112.

Pleas in law and main arguments

Under Art. 96 of the VAT Directive, the standard rate of VAT fixed by each Member State, subject to a minimum rate of 15%, is applicable to all supplies of goods and services. A rate other than the standard rate may be applied

13. For the Commission’s reasoned opinion, see International VAT Monitor 1 (2010), p. 53. The Commission brought similar actions before the ECJ against Sweden (Case C-480/10), the Netherlands (Case C-65/11), and Finland (Case C-74/11).
14. For the announcement of the procedure, see International VAT Monitor 1 (2011), p. 49.
only in so far as that is permitted by other provisions of the Directive.

Art. 98 provides that Member States may apply one or two reduced rates to the supplies of goods and services listed in Annex III to the Directive. The supplies now in issue do not appear in Annex III.

The VAT Directive also contains transitional provisions which permit Member States to continue to apply rates which derogate from the general rules on the structure and level of rates contained in the Directive, if the relevant national provisions were in force on 1 January 1991.

Under Art. 113 of the VAT Directive, where a Member State applied, on 1 January 1991, a reduced rate lower than the minimum laid down in Art. 99, it may apply to those goods and services one of the reduced rates provided for in Art. 98. However, since the rate applied by Ireland to the goods and services now in issue is lower than the minimum set out in Art. 99 of the VAT Directive, Art. 113 can be of no avail.

Art. 110 of the Directive applies to rates lower than the minimum laid down in Art. 99. It lays down a transitional arrangement for certain national measures adopted for clearly defined social reasons (i.e. to reduce the tax burden levied on consumption of goods and services which cover basic social needs) and for the benefit of the final consumer.

The Commission submitted that the supply of horses and greyhounds (other than for use in the preparation of foodstuffs), the hire of horses and insemination services cannot be deemed to be necessary in order to cover basic social needs. The Commission also submitted that, since a large proportion of horses and greyhounds are intended for racing or breeding, the benefit of the measure cannot be considered as lying with the final consumer.

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Preliminary ruling: Case C-117/11 Purple Parking Ltd, Airparks Services Ltd v. The Commissioners for Her Majesty’s Revenue & Customs

By its order of 4 March 2011, the Upper Tribunal (Tax and Chancery Chamber) (United Kingdom) has referred the following questions to the ECJ for a preliminary ruling:

“(1) What particular factors does the referring court have to take into account when deciding whether, in circumstances such as those of the present case, a taxable person is providing a single taxable supply of parking services or two separate supplies, one of parking and one of transport of passengers? In particular:

(a) Is this case covered by the reasoning adopted by the ECJ in Case C-349/96 Card Protection Plan and Case C-41/04 Levoob. In particular, can the transport services in question be regarded as ancillary to the parking services or so closely linked to them that they form, objectively, a single indivisible economic supply, which it would be artificial to split?

(b) In considering question 1(a), what account should the referring court take of the costs of providing the transport services, as opposed to the parking services, in accordance with Paras. 24-26 of the ECJ’s judgment in Joined Cases C-308/96 and C-94/97 Madgett and Baldwin, in assessing whether or not the transport services are ancillary to the parking services?

(c) In the light of the ECJ’s judgment in Case C-572/07 Tellmer, in particular Paras. 21-24, should the referring court, when answering question 1(a), take account of the fact that the transport element of the supplies could be (but is not in fact) provided in a variety of ways (for example, the taxable person could provide those transport services using a third-party provider who invoices the taxable person or could use a third-party provider who contracts directly with the customer and separately charges for the transport services) and to what extent (if at all) is it relevant whether or not the contract gives the customer the right to choose between the different manners in which the transport element could be provided?

(2) When the referring court is considering whether or not there is a single indivisible economic supply in answering question 1(a), what account should it take of the principle of fiscal neutrality? In particular:

(a) Does the answer depend on whether or not the taxable person also provides parking services or transport services separately to other groups of customers?

(b) Does the answer depend on how other transport services to and from airports, not provided by operators of parking services, are treated under national law?

(c) Does the answer depend on whether or not other instances of the provision by taxable persons of parking and transport services (not involving transport to and from airports) are treated under national law as constituting two distinct supplies, one taxable and one zero rated?

(d) Does the answer depend on whether or not the taxable person can show that the services it provides are in competition with other similar services involving both a parking and a transport element, whether provided by the same supplier or provided by two separate suppliers? In particular, does the answer depend on whether the taxable person can show that consumers who wish to use their cars to perform part of the journey to the airport can obtain parking and transport to the airport from individual and separate suppliers, for example by parking at a location near a train station and transport by train from that location to the airport or by parking at a location near an airport and another form of public transport to the airport?

(e) How is the referring court to take account of the conclusions reached by the ECJ in Case C-94/09 Commission v. France in relation to the principle of fiscal neutrality and transport services in that case?
(3) Does EU law and, in particular, the principle of fiscal neutrality, preclude a provision of domestic law which excludes zero rating for transport services between an airport and a car park where the person providing the transport element and the person supplying the car parking element are the same person or connected persons?

**Preliminary ruling: Case C-118/11 Eon Asset Management OOD v. Direktor na Direktsia “Obzhalvane i upravlenie na izpalnenieto”**

By its order of 7 March 2011, the Administrativen sad Varna (Bulgaria) has referred the following questions to the ECJ for a preliminary ruling:

“(1) How must the requirement “are used” established in Art. 168 of Directive 2006/112 be interpreted and, in the framework of assessing the initial establishment of the right of deduction, when must that requirement be satisfied: in the tax period itself in which the goods were purchased or the services received or does it suffice that the requirement is satisfied in a subsequent tax period?

(2) In the light of Arts. 168 and 176 of Directive 2006/112, is a legal rule permissible, such as that established in the domestic provision of Art. 70(1)(2) of the Law on VAT, which allows goods and services “intended for gratuitous transactions or for activities other than the economic activity of the taxable person” to be excluded from the outset from the system of input tax deduction?

(3) If Question 2 is answered in the affirmative: must Art. 176 of Directive 2006/112 be interpreted as meaning that a Member State which sought to take advantage of the option to exclude certain goods and services from the right of deduction and which defined the category of expenditure as follows: the goods and services intended for gratuitous transactions or for activities other than the economic activity of the taxable person except in the cases mentioned in Art. 70(3) of the Law on VAT, satisfies the requirement to adequately define the category of goods and services, that is, to define these by reference to their nature?

(4) Depending on the answer given to Question 3: in the light of Arts. 168 and 173 of Directive 2006/112, how must the purpose (the use or future use) of the goods/services acquired by the taxable person be assessed: as a prerequisite for the initial establishment of the right of deduction or as grounds for the adjustment of the amount of input tax deducted?

(5) If the purpose (use) must be assessed as grounds for an adjustment to the amount of input tax deducted, how must Art. 173 of Directive 2006/112 be interpreted: does it provide for adjustments to be made also in cases in which goods and services are used initially for an activity which is not taxed or following their acquisition not used at all but are at the disposal of the undertaking and in a (tax) period following their acquisition are included in the taxable activity of the taxable person?

(6) If Art. 173 of Directive 2006/112 must be interpreted as meaning that the adjustment envisaged also applies to cases in which, following their acquisition, goods and services are used initially for an activity which is not taxed or not used at all but subsequently are included in the taxable activity of the taxable person, in the light of the restriction established by Art. 70(1)(2) of the Law on VAT and the fact that, pursuant to Art. 79(1) and (2) of the Law on VAT, adjustments may be made only in cases in which goods whose initial use satisfies the requirement for deduction of input tax are subsequently included in a use which does not satisfy those requirements, must it be presumed that the Member State has satisfied its obligation, in relation to all taxable persons, to structure the right of deduction as soundly and fairly as possible?

(7) Depending on the answers given to the previous questions: must it be presumed, having regard to the rules established in the Bulgarian Law on VAT governing restrictions on the right of deduction and adjustments to the amount of input tax deducted, in circumstances such as those of the main proceedings, and in the light of Art. 168 of Directive 2006/112, that, in relation to goods supplied and services carried out by another taxable person, a taxable person registered pursuant to the Bulgarian Law on VAT may deduct the input tax in the (tax) period in which these were supplied to him or carried out on his behalf and in which the VAT became chargeable?

**Action: Case C-119/11 European Commission v. French Republic**

On 4 March 2011, the Commission of the European Union brought an action against the French Republic before the ECJ.

The Commission claimed that the ECJ should declare that, by applying, since 1 January 2007, a VAT rate of 2.10% to income from charges for admission to the first performances of concerts held in establishments where refreshments may be obtained during the performance, the French Republic has failed to fulfil its obligations under Arts. 99 and 110 of the VAT Directive.

**Pleas in law and main arguments**

By the present action, the Commission complained that, since 1 January 2007, the defendant has applied a VAT rate of 2.10% to income from charges for admission to the first performances of concerts held in establishments where refreshments may be obtained during the performance, instead of the earlier rate of 5.5%.

The Commission pointed out that, under Art. 110 of the VAT Directive, Member States which, at 1 January 1991, were applying reduced rates of VAT lower than the minimum rate of 5% may continue to apply those rates. However, Member States are not permitted under that provision to introduce new derogations or extend the scope of the derogations existing as at 1 January 1991 where they have restricted the scope of the derogations after that date. However, that is exactly what occurred in this case, since, as from 1 January 1997, the defendant restricted the scope of the derogation existing as at 1 January 1991 in connection with reduced rates of VAT and expressly
excluded from this income relating to first performances generated by the sale of tickets “which give access solely to concerts held in establishments where refreshments may be obtained during the performance”. By extending the scope of a derogation from the Directive, the French Republic has therefore disregarded the purpose of the Directive.

**Preliminary ruling: Case C-129/11 OOD Provadiinvest v. Direktor na Direksia “Obzhalvane i upravlenie na izpalnenieto”**

By its order of 14 March 2011, the Administrativen Sad Varna (Bulgaria) has referred the following questions to the ECJ for a preliminary ruling:

(1) Is Art. 80(1)(a) and (b) of Directive 2006/112 to be interpreted as meaning that, where there are supplies between connected persons, in so far as the consideration is lower than the open-market value, the taxable amount is the open-market value of the transaction only if the supplier or the acquirer does not qualify for the full right to deduct the input tax chargeable on the purchase or production of the goods which are supplied?

(2) Is Art. 80(1)(a) and (b) of Directive 2006/112 to be interpreted as meaning that, if the supplier has exercised the full right to deduct the input tax on goods and services which are the subject of subsequent supplies between connected persons at a value which is lower than the open-market value, and that right to deduct input tax has not been corrected under Arts. 173 to 177 of the Directive and the supply is not subject to a tax exemption within the meaning of Arts. 132, 135, 136, 371, 375, 376, 377, 378(2), 379(2) and 380 to 390 of the Directive, a Member State is not permitted to adopt measures whereby the taxable amount is exclusively the open-market value?

(3) Is Art. 80(1)(a) and (b) of Directive 2006/112 to be interpreted as meaning that, if the acquirer has exercised the right to deduct in full the input tax on goods and services which are the subject of supplies between connected persons with a lower value than the open-market value, a Member State is not permitted to adopt measures whereby the taxable amount is exclusively the open-market value?

(4) Does Art. 80(1) of Directive 2006/112 constitute an exhaustive list of cases representing the circumstances in which a Member State is permitted to take measures whereby the taxable amount in respect of supplies is to be the open-market value of the transaction?

(5) Is a provision of national law, such as Art. 27(3)(1) of the Zakon za danak varhu dobavenata stoynost (Law on VAT), permissible in cases other than those listed in Art. 80(1)(a), (b) and (c) of Directive 2006/112?

(6) In a case such as the present, does Art. 80(1)(a) and (b) of Directive 2006/112 have direct effect, and may the domestic court apply it directly?

**Preliminary ruling: Case C-142/11 Péter Dávid v. Nemzeti Adó- és Vámhivatal Eszak-alföld Regionális Adó Főigazgatósága**

By its order of 23 March 2011, the Jász-Nagykun-Szolnok County Court (Hungary) has referred the following questions to the ECJ for a preliminary ruling:

(1) Are the provisions relating to VAT deductions in the Sixth Directive and, as regards 2007, in Directive 2006/112 to be interpreted as meaning that the right of deduction of a taxable person may be restricted or prohibited by the tax authority, on the basis of strict liability, if the invoice issuer cannot guarantee that the involvement of further subcontractors complied with the rules?

(2) Where the tax authority does not dispute that the economic activity detailed in the invoice actually took place, nor that the form of the invoice complies with the legal provisions, may the authority lawfully prohibit a VAT refund if the identity of the other subcontractors used by the invoice issuer cannot be determined, or invoices have not been issued in accordance with the rules by the latter?

(3) Is a tax authority which prohibits the exercise of the right of deduction in accordance with Para. 2 obliged to ensure during its procedures that the taxable person with the right of deduction was aware of unlawful conduct, possibly engaged in for the purpose of tax avoidance, of the companies behind the subcontracting chain, or even colluded in such conduct?”

**Preliminary ruling: Case C-153/11 OOD Klub v. Director of the Varna pri Tsentralno upravlenie na Natsionalnata agentzia za prihodite (Varna Office ‘Appeals and the Administration of Enforcement’)**

By its order of 28 March 2011, the Administrativen sad Varna (Bulgaria) has referred the following questions to the ECJ for a preliminary ruling:

(1) Is Art. 168(1)(a) of Directive 2006/112 to be interpreted as meaning that – once a taxable person has exercised his option and allocated property constituting capital goods to his business assets – it must be presumed (that is to say assumed in the absence of evidence to the contrary), that these goods are used for the purposes of taxable transactions effected by the taxable person?

(2) Is Art. 168(1)(a) of Directive 2006/112 to be interpreted as meaning that the right of deduction on the purchase of an immovable property which is allocated to the business assets of a taxable person arises immediately in the tax period in which the tax became due, regardless of the fact that the property cannot be used in view of the absence of approval for its commissioning as required by law?

(3) Is an administrative practice such as that of the Natsionalna Agentzia po Prihodite, according to which the right of deduction claimed by persons liable for VAT on capital goods purchased by them is refused on the grounds that those goods are used for the private purposes of the owners of the companies, without
VAT being imposed on this use, consistent with the Directive?

(4) In circumstances such as those of the main proceed-
ings, does the company, namely the applicant, have a
right of deduction on the purchase of an immovable
property, namely a maisonette in Sofia?”

Preliminary ruling: Case C-165/11 Daňové
riaditeľstvo Slovenskej republiky v. Profitube spol. s.r.o.

By its order of 4 April 2011, the Najvyšší súd Slovenskej
republiky (Supreme Court of the Slovak Republic) has
referred the following questions to the ECJ for a prelimi-
nary ruling:

“(1) In a situation where, in 2005 and 2006, goods from a
non-Member State of the European Union (Ukraine)
were placed in a public customs warehouse in the
territory of a Member State of the European Union by an
importer from that Member State, were subsequently
processed under an inward-processing suspension
procedure in that customs warehouse, and the result-

ing product was not immediately exported within
the meaning of Art. 114 of Regulation No. 2913/92 but
instead was sold in that same warehouse by the
processor of the goods to another company from that
Member State, which did not release it from the cus-
toms warehouse for free circulation but subsequently
returned it to the customs warehousing procedure, is
the said sale of goods within the same customs ware-
house still subject solely to EU customs rules, or has
the legal situation been changed by the said sale to
the extent that the transaction is now subject to the
system under the Sixth Directive, i.e. is it possible,
for the purpose of the system of VAT under the Sixth
Directive, to regard a public customs warehouse loc-
ated in the territory of a Member State as part of the
territory of the European Union, or the territory of
that Member State, in accordance with the definitions
provided in Art. 3 of the Sixth Directive?

(2) In light of the doctrine of abuse of rights developed by
the ECJ and concerning the application of the Sixth
Directive (C-255/02 Halifax16), is it possible to treat
the above as a situation where the applicant, by selling
goods in a public customs warehouse located in the
territory of the Slovak Republic, has already made a
supply for consideration in the Slovak Republic?

(3) If the reply to the first question is in the affirmative, in
that the transaction in question is now subject to the
system under the Sixth Directive, is that transaction
then a chargeable event:

(a) under Art. 10(1) and (2) of the Sixth Directive,
with the tax becoming chargeable as a result of
the delivery of the goods in the customs ware-
house located in the territory of the Slovak Re-
public; or

(b) on the ground that, after the goods were imported
from a third country (Art. 10(3) of the Sixth Di-
rective), the customs procedure ended while the
goods were held in storage in that customs ware-
house upon sale thereof to another person from
the Member State?

(4) Are the objectives of the Sixth Directive, as expressed
in the preamble thereto, or the objectives of the
GATT (WTO) fulfilled if the sale of goods imported
from a third country is a customs warehouse and
then processed therein and sold to another person
from that Member State in the customs warehouse
in the territory of the Member State of the European
Union is not subject to VAT in that Member State?”

Action: Case C-189/11 European Commission v.
Kingdom of Spain

On 20 April 2011, the Commission of the European
Union brought an action against the Kingdom of Spain.

The Commission claimed that the ECJ should declare
that, by applying the special scheme for travel agents in
cases where travel services have been sold to a person
other than the traveller, by excluding from that special
scheme sales to the public, by retail agents acting in their
own name, of trips organized by wholesale agents; by
authorizing travel agents, in certain circumstances, to
charge in the invoice an overall amount that is not rel-
ated to the actual VAT charged to the customer, and by
authorizing the latter, where he is a taxable
person, to deduct this overall amount from the VAT payable; and by
authorizing travel agencies, in so far as they benefit from
the special scheme, to make an overall determination of
the basis of assessment of the tax for each tax period,
the Kingdom of Spain has failed to fulfil its obligations
under Arts. 73, 168, 169, 226 and 306 to 310 of the VAT
Directive.

Pleas in law and main arguments

The Commission considers that the application by the
Kingdom of Spain of the special scheme for travel agents,
in so far as it is not limited to services provided to travel-
 ers, as the directive prescribes, but is extended to op-
erations carried out between travel agents, infringes the
provisions of the legislation concerning VAT.

Furthermore, the exclusion from that special scheme of
sales to the public, by retail agents acting in their own
name, of trips organized by wholesale agents is not com-
patible with the Directive either, as such activities, with-
out any doubt in the opinion of the Commission, fall
within the activities covered by the special scheme.

 Likewise, the Commission considers that the Spanish
rules authorizing travel agents, without any basis in that
Directive, to charge in the invoice an overall VAT amount
that is not related to the actual VAT charged to the cus-
tomer, or that authorize the latter, where he is a taxable
person, to deduct this overall amount from the VAT pay-
able, or that allow travel agencies, in so far as they benefit
from the special scheme, to make an overall determina-

16. ECJ judgment of 21 February 2006 in Halifax plc, Leeds Permanent Development Services Ltd, County Wide Property Investments Ltd v. Com-
tion of the basis of assessment of the tax for each tax period, infringe the VAT directive.

**Action: Case C-193/11 European Commission v. Republic of Poland**

On 20 April 2011, the Commission of the European Union brought an action against the Republic of Poland. The Commission claimed that the ECJ should declare that, by applying the special VAT scheme for travel agents in cases involving the sale of travel services to persons who are not travellers, as provided for in Art. 119(3) of the Law of 11 March 2004 on the taxation of goods and services (the Polish Law on VAT), the Republic of Poland has failed to comply with its obligations under Arts. 306 to 310 of the VAT Directive.

**Pleas in law and main arguments**

In the Commission's view, the application by the Republic of Poland, on the basis of Art. 119 of the Polish Law on VAT, of the special VAT scheme for travel agents also to cases in which the recipient of travel services is not a traveller is incompatible with Arts. 306 to 310 of the VAT Directive as currently in force.

In support of its contention, the Commission submits that Arts. 306 to 310 of the VAT Directive correspond to the wording previously set out in Art. 26 of the Sixth Directive. Five out of the six official language versions at that time (that is to say, all of the language versions except for the English) were entirely consistent and consistently used the term “traveller” throughout the text of Art. 26. The use of the term “customer” (“nabywca”) is found solely in a number of language versions of Art. 306 of the VAT Directive which are based on the English-language version. In those cases, however, the further provisions relating to the special scheme (Arts. 307 to 310) use the notion of “traveller”, which indicates that the notion of “customer” was wrongly used in Art. 306.

Furthermore, even if it were to be agreed that the purpose of the special VAT scheme for travel agents, that is to say, the simplification of account settling, would be more effectively achieved by an interpretation which took account of customers, it appears from the ECJ’s case law that application of that scheme based exclusively on a purposive construction, contrary to the unequivocal decision of the EU legislature which follows from the content of the provisions currently in force, cannot be supported.
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