Issue No. 5, 2014

VAT newsletter

Introduction

Welcome to the fifth issue of Ernst & Young LLP's 2014 *VAT newsletter* for the US. These newsletters cover a variety of topics, as VAT can impact businesses in many ways. Approximately 150 countries around the world now have a VAT, goods and services tax (GST), consumption tax, service tax or similar VAT, and the laws and regulations are constantly changing. We use this newsletter as a way of informing you of significant changes taking place.

At the end of this newsletter you will find contact details for the senior members of our team who can help answer any questions you may have about the articles in this newsletter, or any other VAT questions.

We are interested in your feedback on the items covered and what topics you would like to see covered in the future. Please provide any feedback to Howard Lambert at howard.lambert@ey.com.

If you would like to subscribe to receive EY's *Indirect Tax* updates, please click here.

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EY

Building a better working world

Global

EY's *2014 Worldwide VAT, GST and Sales Tax Guide*

You can access the 2014 guide **here**.

OECD — Governments endorse new OECD guidelines on applying VAT/GST across borders

The governments of 86 countries have endorsed the first internationally agreed **guidelines** for applying national value-added tax rules to cross-border transactions, the Organisation for Economic Co-operation and Development (OECD) announces. The OECD says that the framework is a key step toward preventing VAT/GST from weighing on trade while also safeguarding state revenue. A key focus of the framework is to ensure that VAT is imposed on private consumption and not businesses. The action was taken during an April 17-18 meeting in Tokyo of the OECD's new Global Forum on VAT/GST. More than 250 high-level officials from about 100 countries, jurisdictions and international organizations endorsed a new set of OECD guidelines for applying VAT/GST or the goods and services tax to international trade.

Americas

Bahamas — Finance releases draft legislation for VAT

The Bahamian Government has published the draft VAT Bill and Regulations. If approved, the VAT would take effect on 1 July 2014, but from press articles in the Bahamas it would appear that the introduction has now been pushed back. From the draft VAT Bill, it would appear that non-resident businesses will need to register for VAT in the Bahamas if they supply telecommunication services and electronic commerce to persons residing or located in the Bahamas.

Asia-Pacific

Regional — EY's publication: *Strategically managing indirect taxes in Asia-Pacific*

Tax compliance is under greater scrutiny than ever before with companies publicly reprimanded in the media for not paying their "fair share" of tax. As a result, executives, tax staff, audit committee members and other interested stakeholders are more mindful of the risks associated with getting their tax positions wrong.

Robert Smith, EY's Asia-Pacific Indirect Tax Leader, explains that "indirect taxes in Asia-Pacific are no different, and it could be argued, [they] are even more susceptible to potential risks than direct taxes as many companies have not deployed sufficient resources and efforts to proactively manage and ensure compliance."

"Asia-Pacific is a crucial growth market for many multinationals. But managing indirect tax strategically in the region is no easy task. There is no 'one-size-fits-all' management approach that can be deployed across such a diverse group of different countries and taxes. It takes concerted effort and dedication to develop an approach that fits each organization. For most companies, this is a journey," he said.

Our thought leadership report provides an analysis of the struggles and successes organizations face and practical insights. It outlines a process for continual upgrading regional understanding, assessing and then proactively managing indirect taxes in Asia-Pacific. To review EY's report, please click here.

Europe

European Commission — Publication of explanatory notes on the EU VAT place of supply changes from 2015

On 3 April 2014, the European Commission published a set of explanatory notes which have been prepared in order to provide a better understanding of the EU legislation relating to the changes to the VAT place of supply rules for telecoms, broadcasting and electronic services supplied to EU resident individuals, which will take effect from 1 January 2015. From this date, instead of VAT being payable in the Member State where the supplier is established, it will become due where the customer is located. The explanatory notes focus on the place of supply implementing measures (principally Council Implementing Regulation (EU) No 1042/2013) which apply across all Member States. The Commission intends that this information will help businesses to prepare for and comply with the new VAT rules. It should be noted that these explanatory notes are not legally binding, but have been offered to provide practical and informal guidance reflecting the Commission's views on how EU law should be understood and applied.

The explanatory notes and more information on the 2015 changes can be accessed by clicking here and here, respectively.

European VAT case — Advocate General Opinion on Skandia America: VAT treatment of cross-border intra-company transactions within a VAT group

On 8 May 2014, the Court of Justice of the European Union (CJEU) released the opinion of the Advocate General (AG) in the Swedish case of Skandia America Corporation USA, Sweden branch (C-7/13).

The AG's opinion will be of interest to businesses in the finance and insurance sectors, as well as other partly exempt or VAT averse businesses, where the VAT treatment of cross-border intra-company transactions within a VAT group is of relevance. If the CJEU follows the AG's opinion, the case could have wider implications for businesses operating in countries where penalties for not accounting for the reverse charge may be significant. It is important to note that the AG's opinion is not binding; nevertheless, affected businesses should consider their position in preparation for the risk of the CJEU following the AG's opinion.

Background

In the current case, the US parent company and head office buys software and software maintenance services which it supplies to its Swedish branch, which is VAT registered as a member of a Swedish VAT group.

The cost of these supplies is recharged by the head office to the Swedish branch at cost plus 5% for transfer pricing purposes. The Swedish branch has staff and resources, and adds value to those services that it supplies on to other VAT group members.

The Swedish tax authority registered the US head office and assessed for Swedish VAT on the basis that the head office and branch should be treated as separate entities and that the branch created an establishment of the US head office in Sweden from which services were supplied to the VAT group members.

The Swedish court referred the following questions to the CJEU:

- Do supplies of externally purchased services from a company's main establishment in a third country to its branch in a Member State, with an allocation of costs for the purchase by the branch, constitute taxable transactions if the branch belongs to a VAT group in the Member State?
- If the answer to the first question is in the affirmative, is the main establishment in the third country to be viewed as a taxable person not established in the Member State within the meaning of the VAT Directive, with the result that the purchaser is to be taxed on the transactions?

The issue

The referral of this case by the Swedish tax authorities has caused concern for many businesses as the subsequent CJEU judgment may impact the treatment of both inter- and intra-company transactions, where a company has an establishment that is a member of a VAT group in an EU Member State. In particular, concerns have arisen due to views expressed by the European Commission that, once a branch or establishment joins a VAT group, its identity for VAT purposes becomes that of the VAT group and it is effectively no longer seen as the same taxable person as its head office. The implication of this view being that where a branch is a member of a VAT group, transactions between it and its head office can no longer be disregarded (i.e., the principles set out in the CJEU case of FCE Bank plc (C-210/04) would not apply where a VAT group is involved). Should the Commission's view be confirmed, businesses will need to account for the reverse charge on inter-/intra-company transactions creating additional complexity and, for partly exempt and VAT averse businesses, additional cost.

The AG's opinion

At the time of writing, the English translation of the AG's opinion has not been published. However, we consider that the AG's opinion identifies the following points:

- As a branch is not independent of its main establishment, the overseas entity itself becomes a member of a VAT group in a Member State through its locally established branch.
- As found in the case of FCE Bank plc, transactions between the main (i.e., overseas) establishment and its branch do not constitute taxable transactions for VAT purposes.

The AG has also commented on the key issue of whether services can be received without VAT being incurred, where the branch is both part of a VAT group and part of the same legal entity as its overseas establishment. However, there is a distinct lack of clarity in the AG's conclusion on this point. The AG appears to opine that VAT should be accounted for by the VAT group under the reverse charge. However, it is important to note that the services in the case in question consisted of services that had been purchased from third-party suppliers by the main establishment (i.e., bought-in services). We do not believe that the AG has considered the VAT treatment of services supplied by the main establishment using its own resources — the AG's opinion does not provide certainty on this point. However, we consider that, to the extent that only supplies of bought-in services are to be treated as taxable transactions, when supplied by the main establishment to a VAT group (of which a branch of the main establishment is a member), the position will be comparable to the current UK position. We believe some comfort on this point can be drawn from the fact that the AG's opinion refers regularly to the UK position while stating that the result of transactions such as those in question should not be the avoidance of VAT.

What is the impact for businesses?

Uncertainty will remain as to the likely impact of this case for businesses until the opinion of the AG is published in English, and we are not confident that an English translation will completely clarify the position. Ultimately, until the CJEU itself releases its judgment, this matter will continue to create uncertainty. Positively, the AG's opinion is in parts consistent with the current approach in the UK. In particular, the view that the addition of an establishment of an overseas entity to a VAT group is, in fact, the addition of that overseas entity in its entirety to the VAT group, and the view that transactions between establishments of the same legal entity are to be disregarded. While the precise scope of the AG's comments on the application of reverse charge VAT to transactions between the overseas establishment and the VAT group cannot currently be confirmed, to the extent that the reverse charge is to apply to transactions concerning bought-in services only, this should be broadly similar to the current UK position (i.e., the reverse charge is applicable under the anti-avoidance provisions in section 43(2A) of the Value Added Tax Act 1994). In such circumstances, there may be an impact for businesses that have branches or establishments in other EU Member States, as Member States that do not already have anti-avoidance provisions in place may implement such provisions in the future. Conversely, an opportunity to reduce local reverse charge VAT may arise in Member States where the reverse charge is applied to all transactions with the local VAT group.

If, however, it is ultimately concluded that the reverse charge should apply to all transactions involving overseas establishments and EU VAT groups the implications would be significant. Specifically, a need to account for reverse charge VAT on all inter-/intra-company transactions involving taxable supplies, where either the supplying establishment or receiving establishment is a member of a VAT group, would increase the VAT accounting burden on businesses and, where the business is partly exempt, create additional irrecoverable VAT costs. Any decision of this nature will not be welcomed by financial services businesses, many of which operate through branch networks for regulatory and capital efficiency reasons.

Pending the judgment in this case, businesses are advised to review their current operations and VAT accounting in respect of their existing branches/overseas establishments and VAT groups to identify where additional reverse charge VAT could arise.

Sweden — Changes in import VAT

The Swedish Parliament decided on 5 December 2013 that companies registered for VAT purposes in Sweden must report their VAT on importation to the Swedish Tax Agency instead of paying it to Customs (*Sw Tullverket*). The amendment enters into force on 1 January 2015. There are no transitional provisions or exemptions from this new provision. This means that as of 1 January 2015, importing companies that are registered for VAT purposes in Sweden, will report and pay import VAT to the Swedish Tax Agency instead of to Customs. Thus, their import VAT must be included in the regular VAT return.

Middle East, India and Africa

Egypt — Draft VAT law

On 9 April 2014, the head of the Egyptian Tax Authority announced that Egypt is in the process of introducing a VAT law that will replace the existing general sales tax system. The draft VAT law is currently under discussion between the tax authority and the business community. The most important features of the draft law are summarized as follows:

- VAT will apply on all goods and services whether produced/rendered locally or imported.
- A single standard VAT rate will apply instead of the multiple sales tax rates. The standard VAT rate is not determined yet but is expected to range between 10% and 12%.
- Operations carried on in Free Zones will be subject to VAT. A special VAT refund mechanism will be introduced for inputs used by Free Zone companies and connected to export operations. The time limit to process refund claims will be shortened for Free Zone companies compared to other businesses.
- A zero rate will apply to the following transactions:
  - Goods and services intended to be exported
  - Goods imported and intended to be used outside Egypt
  - Goods and services to be used to repair equipment that are imported to Egypt on a temporary basis
  - Goods intended for the exploitation of international transport means
  - Goods and services intended for military purposes imported by the Ministries of Defense and Interior and by specific national military agencies
- A reverse charge mechanism (VAT self-assessment) will be introduced for services rendered by non-resident suppliers to customers in Egypt. Overseas service providers will not charge VAT to their customers. Instead, the Egyptian customers will need to account for VAT on the received services through their periodic VAT return and pay the VAT due within 30 days from the date of service.
- Accounting records and supporting documents will need to be retained for a period of five years.

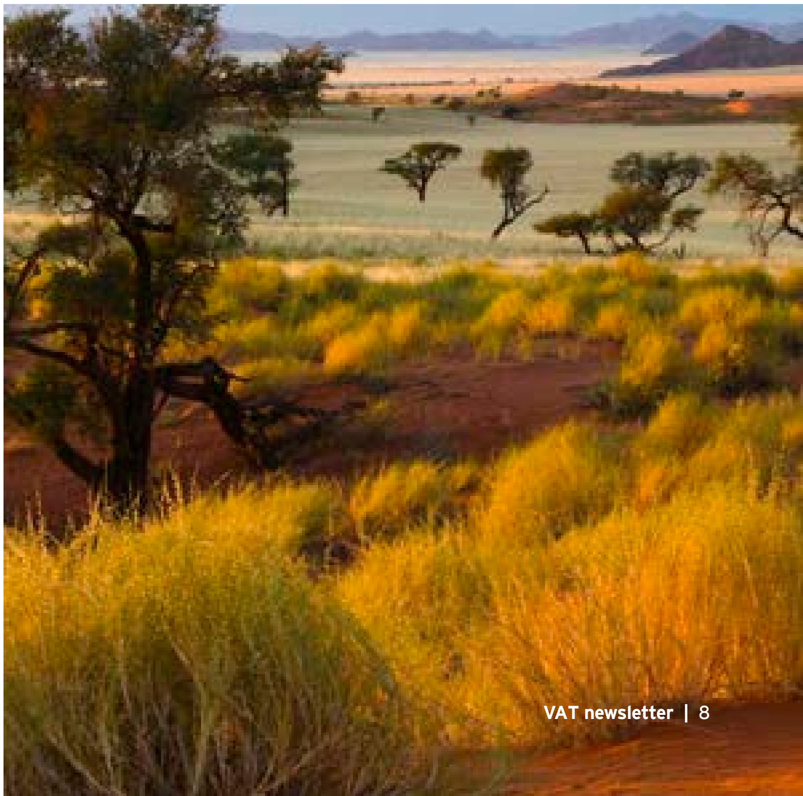
South Africa — New VAT rules relating to the exportation of goods

On 2 May 2014, the South African Revenue Service (SARS) released a new regulation prescribing the rules under which indirect exports may be zero-rated or when a recipient is entitled to a VAT refund when goods are exported. In addition, an updated Interpretation Note 30 prescribing the rules and documentary requirements under which direct exports may be zero-rated was released on 5 May 2014.

The South African VAT Act makes a distinction between so-called direct and indirect exports. Where the supplying vendor is responsible for physically delivering the movable goods or if the supplying vendor obtains the services of a cartage contractor to deliver the movable goods in terms of a sale or instalment credit agreement to a recipient situated at an address outside South Africa, the supply will be regarded as a direct export. Where the responsibility for the removal of the movable goods from South Africa is that of the recipient of the goods it will be regarded as an indirect export.

The new rules applying to direct and indirect exports will affect all vendors exporting goods from South Africa with effect from the dates that the above regulation and interpretation note were released.

All vendors exporting goods will be required to assess the effect of the new VAT rules on their export supplies.



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EY newsletters and alerts

If you would like a copy of a green paper, newsletter or alerts covering some of the topics mentioned below, please contact Howard Lambert at howard.lambert@ey.com.

EY Indirect Tax FSOverview, March 2014: Read more here.

Canada: ***Finance releases draft legislation for sales tax technical amendments***
On 8 April 2014, the Department of Finance released for public comment draft legislative proposals and Explanatory notes relating to technical changes to the Excise Tax Act and related regulations.

Croatia: *Tax news* 03/2014: EY Croatia has recently published the 03/2014 edition of its regular newsletter, *Tax news*.

Czech Republic: Click here for the latest edition of the *Czech Republic Tax Alert*. Prepared by EY's Czech Republic's Tax Department, this update provides a review of recent legislative and international tax news. Highlights of this edition include: the war over VAT (and the Gordian knot) and implementing amendments to the VAT Act.

Hungary: *EY Tax News* Issue 03/2014.

Netherlands: *Tax Update Weekly*: issue 15, issue 16, issue 17, issue 18 and issue 19. Weekly client e-newsletter offers a roundup of VAT news from the Netherlands, EU and other countries.

Slovakia: *EY Tax news* 4/2014.

UK: *EY VAT News* – weeks ending: 7 April 2014, 14 April 2014, 21 April 2014, 29 April 2014, and 5 May 2014. Weekly client e-newsletter offers a roundup of VAT news from UK, EU and other countries.

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