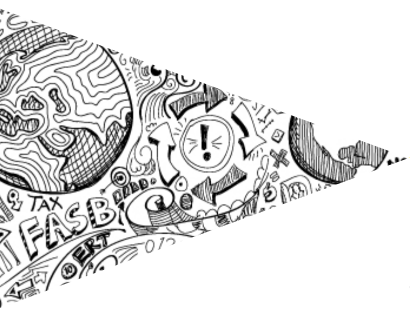
Issue No. 8, 2013

VAT newsletter



Introduction

Welcome to the eighth issue of Ernst & Young LLP's 2013 *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.

Summary of items included in this newsletter

Global

OECD – VAT guidelines need clear definition of permanent establishment

Americas

Chile – Electronic invoicing

Mexico – Electronic invoicing

US – Senator Ben Cardin urges consideration of a national consumption tax

Asia-Pacific

China – Announcement of the long-awaited trial administrative measures for VAT exemption on cross-border services

Japan – Government confirms scheduled initial increase in consumption tax rate

New Zealand – Enhanced GST registration for nonresidents

Europe

Netherlands – Judgment of the European Court of Justice: right to recover VAT on day-to-day management and investment activities of its own employee pension fund

Russia – Government has adopted the long-awaited list of VAT-exempt financial services

Ukraine – Procedure for VAT refunds through Treasury Bills clarified

Middle East, India and Africa

Jordan – Sales tax rates increased on mobile telecommunication devices and services

South Africa – National Treasury proposes simplified VAT registration process

Building a better
working world

Global

OECD — VAT guidelines need clear definition of permanent establishment

Recent draft international guidelines on VAT should be revised to clearly define what a business "establishment" is for the purpose of applying VAT to services and intangible goods across multinational enterprises and to clearly explain how the guidelines interact with existing transfer pricing rules, practitioners, business groups and multinationals (e.g., in comment letters). The Paris-based Organisation for Economic Co-operation and Development (OECD), whose 34 member countries include the world's advanced economies, released 31 letters regarding the 63-page consolidated version of the draft OECD International VAT/GST Guidelines that it published 4 February 2013 and accepted comments until 4 May 2013.

Americas

Chile — Electronic invoicing

On 17 July 2013, the Lower House passed a bill that introduces several tax changes. The main measures consolidate the electronic invoicing rules.

The official announcement by the Lower House focuses on the following changes with regard to electronic invoicing:

- A beneficiary will be able to claim refunds of VAT shown on an electronic invoice under Law 19,983.
- Electronic invoicing complies with the probative value requirements.
- Tax authorities cannot demand sales slips. The bill forecasts a 24-month transition period for the applicability of this measure.

Mexico — Electronic invoicing

On 15 July 2013, the Tax Administration Service issued a press release indicating that, as from 2014, taxpayers with a turnover exceeding MXN250,000 (approximately US$19,500) a year must issue electronic invoices regardless of the level of sales.

US — Senator Ben Cardin urges consideration of a national consumption tax

A national consumption tax would be a viable alternative to income taxes for most individuals and businesses, Senator Ben Cardin (D-Md.) said 1 August 2013. A VAT ought to be considered in the context of revamping US tax laws, Cardin told reporters gathered in his office to discuss tax reform. He admitted that it would represent a radical departure from the current system, which is based on income taxes rather than consumption taxes, but Cardin said the reality is that reforming the tax code in any way is proving difficult.

Asia-Pacific

China — Announcement of the long-awaited trial administrative measures for VAT exemption on cross-border services

Recently, the State Administration of Taxation (SAT) released SAT Announcement [2013] No. 52 (Circular 52), which sets out the trial measures for the VAT exemption of cross-border services. Circular 52, dated 13 September 2013, is effective starting from 1 August 2013.

The SAT had been formulating detailed rules covering the administrative measures that govern how taxpayers engage in the provision of cross-border services since the implementation of the VAT Pilot in Shanghai on 1 January 2012. As the VAT exemption would have significant impact on tax collection, the SAT performed detailed research and consulted with the Ministry of Finance and the finance bureaus and tax bureaus of various VAT Pilot locations. After close to 20 months of research and consultation, the SAT announced the trial administrative measures for VAT exemption on cross-border services, shortly after the nationwide expansion of the VAT Pilot for transportation and selected modern services.

Please click here for a copy of the Indirect Tax alert issued by our colleagues in China.

Japan — Government confirms scheduled initial increase in consumption tax rate

Overview of phased-in increases to consumption tax rate

The consumption tax rate will increase to 8% (including local consumption tax of 1.7%) effective 1 April 2014, in accordance with previously enacted legislation. A further increase to 10% (including local consumption tax of 2.2%) effective 1 October 2015 is also enacted.

Rate to increase to 8% as initially planned

On 1 October 2013, Prime Minister Shinzo Abe announced that the consumption tax rate will increase to 8% as of 1 April 2014, from the current rate of 5%.

The revised Consumption Tax Law (enacted on 22 August 2012) includes a general provision for this first phase of rate increase. It also includes an "economic resiliency" clause, which serves as a mechanism whereby the increase can be canceled if deemed necessary based on prevailing economic conditions. In making this determination, the overall economic situation is to be considered, with reference to key indicators such as nominal GDP, real GDP and price trends.

Abe's announcement has confirmed that this economic resiliency clause will not be invoked to cancel the first phase of the rate increase, and as a result the consumption tax rate will become 8% effective 1 April 2014 as initially planned.

Planned further rate increase to 10%

Similarly, the enacted second phase of the consumption tax rate increase to 10% as of 1 October 2015 is accompanied by this economic resiliency clause, such that another determination of the overall economic situation will be made prior to its implementation.

Transitional measures regarding the rate increase to 8%

A number of transitional measures provide for continued application of the current 5% rate following the effective date of the general rate increase, in certain situations. The main impacted transactions are outlined below. There are also other important transition measures to be considered. Please contact your EY advisor for details.

Transactions with 1 October 2013 as key date

- **Construction contracts:** the taxable sales on or after 1 April 2014 pursuant to a construction contract, etc. concluded prior to 1 October 2013
- **Property leases:** lease payments made on or after 1 April 2014 pursuant to a lease agreement concluded prior to 1 October 2013, the term of which begins prior to and extends beyond 1 April 2014
- **Books, etc., subscriptions:** the sale of books, etc. on or after 1 April 2014 pursuant to a subscription agreement concluded prior to 1 October 2013 for provision thereof at a fixed frequency to members of the general public and for which payment was made before 1 April 2014
- **Mail order and online sales:** the sale of products on or after 1 April 2014 via mail order or online platforms, for which the vendor had advertised (or completed preparations to advertise) sales terms including the price prior to 1 October 2013, the order was received prior to 1 April 2014 and the sale is made in accordance with those advertised terms

Transactions with 1 April 2014 as key date

- **Travel fares and admission fees:** the transport of passengers, or admission of customers to movies, theaters, horse races, bicycle races, art galleries, amusement parks or similar entertainment venues, on or after 1 April 2014, for which fees were paid prior to 1 April 2014
- **Utility charges:** charges relating to the continuous provision of electricity, gas, water or telecommunications pursuant to an agreement with a term beginning prior to and extending beyond 1 April 2014, for which the right to receive payment is established between 1 April and 30 April 2014
- **Newspapers and magazine sales:** the sale of certain newspapers or magazines on or after 1 April 2014, for which the specific release dates were prior to 1 April 2014, and for which delivery to the general public occurs at a fixed frequency such as weekly or monthly
- **Long-term installment sales:** installment payments with a due date on or after 1 April 2014 pursuant to sales that occurred prior to 1 April 2014

New Zealand — Enhanced GST registration for non-residents

Several changes to the GST legislation passed into law on 17 July 2013, many of which are aimed at nonresidents as part of an effort to reduce the GST cost for non-established businesses trading in New Zealand.

Included in the changes was the introduction of a new "enhanced GST registration" for nonresidents doing business in New Zealand. This will apply from 1 April 2014.

The change allows nonresident businesses to register for GST without making taxable supplies in New Zealand. Nonresidents will be able to register using the enhanced registration system if either of the following is satisfied:

- The nonresident is registered for a consumption tax in its country of residence.

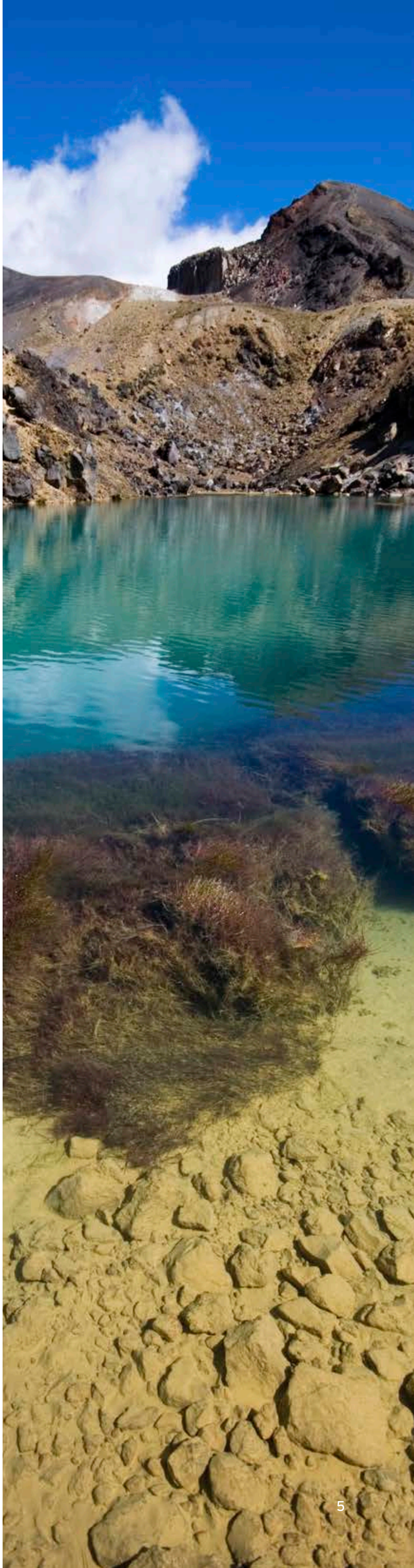
  Or
- If no consumption tax system is in place, the nonresident carries on a taxable activity off-shore with a turnover exceeding NZ$60,000, and the input tax in New Zealand for the first period of registration is more than NZ$500.

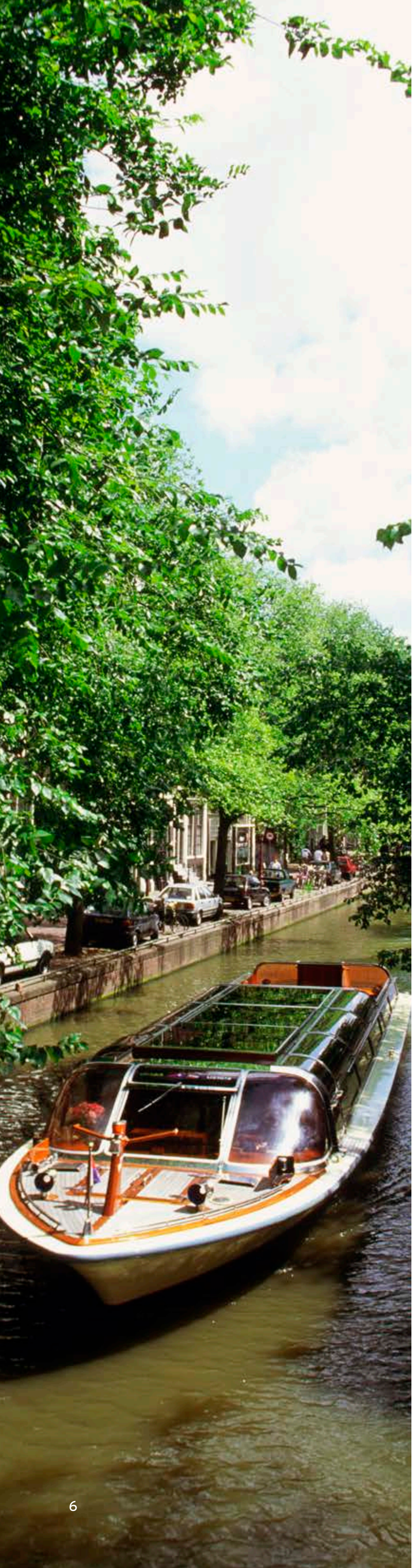
The intention of the change is to eliminate the competitive disadvantage caused by irrecoverable GST incurred by nonresidents.

There are some consequential amendments that could adversely impact some nonresidents already doing business in New Zealand, such as disallowing the GST grouping of nonresidents with resident companies from 13 September 2012.

In addition to the enhanced GST registration system, the following changes have also been enacted:

- An opt-out option allows agents and principals to agree to treat the principal's provision of goods and services to the agent and the agent's onward supply as separate supplies for GST purposes. This effectively enables two tax invoices to be issued for the same supply. The use of bad debt rules will be limited when principals and agents use this new invoicing procedure. This change applies from the date of enactment, 17 July 2013.
- A new zero-rating rule allows GST-registered manufacturers to zero-rate the supply of certain tooling costs charged to a nonresident customer. This change applies from 1 April 2014.
- There is added flexibility in keeping tax records overseas.





Europe

Netherlands — Judgment of the European Court of Justice: right to recover VAT on day-to-day management and investment activities of its own employee pension fund

The European Court released its judgment on 18 July 2013 in this Dutch referral asking whether an employer is entitled to recover the VAT on costs incurred in connection with the day-to-day management and investment activities of its own employee pension fund, as being for the purpose of the employer's normal business activities. The referral also asked whether a pension fund can be regarded as a "special investment fund" for the purposes of Article 135(1)(g) of the VAT Directive, the management of which qualifies for VAT exemption. For completeness, the European Court released the Opinion of Advocate General Sharpston on 18 April 2013.

PPG, a fully taxable group of companies, set up a pension fund for its employees, into which the companies paid contributions. The employees made no pension contributions (i.e., the fund was a defined benefit, or final salary, scheme). PPG contracted with (and paid) various service providers for the administration of the pension fund and the management of its assets. Those costs were not passed on to the pension fund. PPG sought to deduct as input tax the various amounts of VAT incurred on these services, which the tax authorities subsequently disallowed. The referring court asked whether PPG was entitled to deduct the VAT incurred on these costs (as being attributable to its fully taxable business). If not, the question was whether the services were properly exempt from VAT by virtue of Article 135(1)(g).

On the VAT recovery issue, the European Court held that, despite the fact that the pension fund was a separate legal entity, PPG was legally required to make pension provisions for its employees, such that the costs of doing so formed part of its general overheads and were components of its taxable supplies. On this basis, the European Court held that PPG was entitled to deduct the VAT incurred on related costs. On the exemption issue, the European Court held that this matter was dealt with (and answered in the negative) by the European Court in its recent judgment in the case of Wheels Common Investment Fund Trustees Ltd (C-424/11) (i.e., the services were not exempt from VAT).

The Court summary judgment reads:

> "Article 17 of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment must be interpreted as meaning that a taxable person who has set up a pension fund in the form of a legally and fiscally separate entity, such as that at issue in the main proceedings, in order to safeguard the pension rights of his employees and former employees, is entitled to deduct the value added tax he has paid on services relating to the management and operation of that fund, provided that the existence of a direct and immediate link is apparent from all the circumstances of the transactions in question."

The full judgment can be accessed by clicking here.

Russia — Government has adopted the long-awaited list of VAT-exempt financial services

The provisions of the Russian Tax Code related to VAT-exempt operations were extended by Federal Law No. 145-FZ of 28 July 2012 to include services rendered in the securities, commodity and currency markets.

The list of the VAT-exempt services includes, among others, services rendered by brokers, dealers, registrars, depositaries, securities managers, management companies of investment funds, mutual investment funds and non-State pension funds, clearing organizations and trade organizers on the basis of their respective licenses to carry out such types of activity.

The VAT exemption also applies to certain services auxiliary to the aforementioned services, if such services are named in the list established by the Government.

The task force for the creation of the International Financial Center in Russia actively participated in the process of preparing the aforementioned list of VAT-exempt services.

The list of VAT-exempt services was extended to include, for example, broker consulting services related to the organization of the issuance and placement (offering) of securities and to investment in financial instruments, which are provided by the Federal Law "Concerning the Securities Market." According to this law, the list of financial instruments includes various types of the securities and derivative financial instruments. Furthermore, the decree provides an opportunity for asset managers of investment funds and non-State pension funds not to charge VAT on consulting services with regard to all investments (not only those related to financial instruments).

Interestingly, one of the drafts of the decree included a VAT exemption for consulting services related to mergers and acquisitions, but they were excluded from the final version of the list.

What are the next steps?

The decree came into force on 13 September 2013. However, the decree covers legal relationships that have arisen since 1 January 2013. With regard to the retrospective nature of the decree, financial services companies mentioned in the decree and their clients should work out their approach to operations they have executed since 1 January 2013.

We believe that many practical questions may arise with regard to the application of the decree for financial services companies and their clients.

Clients should request that financial services companies pay back the amounts of VAT paid for services rendered in 2013. In that case, financial services companies will have to claim a refund of the VAT paid to the tax authorities and related to services rendered in 2013 by way of submitting amended VAT returns. As amended VAT returns should be subject to an obligatory desk tax audit, the tax authority could potentially delay or challenge the refund of VAT. For refund of VAT to foreign clients, companies should pay attention to the requirements of currency control legislation, confirm such VAT refunds with the respective authorized banks and make sure that they have all required contractual documentation.

The recalculation of revenue subject to VAT according to the decree by companies that make both VATable and VAT-exempt supplies will most likely lead to the reduction in the amount of input VAT claimed for recovery in 2013, due to an increase in the proportion of revenue not subject to VAT.

The Tax Code and the decree apply solely to licensed professional participants of securities markets and other regulated organizations specified in the Tax Code. In this regard, it might be beneficial to reconsider the existing business models where services indicated in the decree are provided by non-regulated companies, such as by Russian branches of foreign companies.

Ukraine — Procedure for VAT refunds through Treasury Bills clarified

The Rada (Ukrainian parliament) adopted the Law of Ukraine "On Amendments to the Law of Ukraine 'On the State Budget of Ukraine'" (draft law No. 2290a of 13 June 2013) and the Law of Ukraine "On Amendments to the Tax Code of Ukraine" (draft law No. 2847 of 17 April 2013).

Based on these laws:

- The Cabinet of Ministers now has the right to restructure budget indebtedness for state budget expenditures that arose as of 1 January 2013 by issuing promissory notes with a circulation period of no more than five years and with a 5% yield. The right to issue such notes is granted to the State Treasury Service.
- Taxpayers have gained the right to receive VAT refunds in the form of promissory notes according to the process that the Cabinet of Ministers establishes.
- VAT refunded using financial promissory notes will be divided into five equal parts. For each, a separate note will be issued with a circulation period of one, two, three, four or five years.
- Taxpayers will be eligible to settle taxes using financial promissory notes, but not before the maturity period defined by the notes. Presentation of a promissory note qualifies as settlement of consentaneous money liabilities in cash.

Middle East, India and Africa

Jordan — Sales tax rates increased on mobile telecommunication services

On 10 July 2013, the Government increased the special tax rates on mobile telecommunication devices and services as follows:

- From 8% to 16% on mobile phones, including smartphones
- From 12% to 24% on mobile subscriptions

The Amendment was published on 10 July 2013 in the Official Gazette No. 5229 of 2013 and came into effect that day.

South Africa — National Treasury proposes simplified VAT registration process

Entry into the South African VAT system has long been problematic for a variety of businesses. Many small businesses, foreign-owned new entrants and capital-intensive businesses with long-lead start-up times have often found themselves unable to obtain timely VAT registration.

VAT registration is important in South Africa as a precondition for entering into contractual relationships with the South African Government and larger South African entities. VAT registration is also important for obtaining early refunds for large-scale input start-up costs.

Under the 2013 proposed legislation, voluntary entry into the VAT system will mainly be achieved through two means. Taxpayers can enter into a "VAT-lite" system by carrying on an enterprise or intending to carry on an enterprise as long as taxable supplies are made within 12 months from the date that the enterprise commences.

Under this VAT-lite system, taxpayers can charge VAT and receive inputs to the extent of outputs. However, taxpayers may not receive VAT refunds until taxable supplies exceed ZAR100 000 (approximately US$10,150). This limitation on refunds is intended to prevent fraudulent use of the VAT system. Other prospective businesses can achieve full entry with a ZAR5 million investment or a ZAR5 million (approximately US$507,500) contractual commitment (or have a ZAR1 million (approximately US$101,500) annual turnover). This latter set of entrants will have full access to the VAT system, including refunds.

Businesses outside the VAT net should accordingly review their circumstances to determine if they satisfy the proposed rules for VAT entry. The proposed legislation should also be checked for anomalies so that businesses currently remaining outside the system can send comment to the National Treasury for adjustment.

EY | Assurance | Tax | Transactions | Advisory

SCORE No. YY3109
1310-1141933

ED 1401

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.

Austria: *International Tax Review*, August 2013

Canada: Alert regarding changes to Quebec sales tax

Croatia: *Tax News*, May 2013

Czech Republic: *Tax News*, July 2013

Financial Services and VAT: overview, July 2013

Germany: *VAT Alert* — Partnerships eligible for inclusion in VAT groups

Hungary: *Tax Express*, July 2013

Hungary: *Tax News*, July 2013

Italy: *Annual Report of Purchases and Sales*

UK: *VAT News*, weeks ending 22 and 29 July 2013 and 5 August 2013

Ernst & Young LLP

US VAT practice leaders:

Karen Christie
New York, NY
+1 212 773 5552
karen.christie@ey.com

Ronnie Dassen
New York, NY
+1 212 773 6458
ronnie.dassen@ey.com

Anne Freden
San Francisco, CA
+1 415 894 8732
anne.freden@ey.com

Michael Leightman
Houston, TX
+1 713 750 1335
michael.leightman@ey.com

Regional resources:

Ela Choina
Chicago, IL
+1 312 879 2935
ela.choina@ey.com

Alex Cotopoulis
New York, NY
+1 212 773 8216
alex.aotopoulis@ey.com

Maria Hevia Alvarez
New York, NY
+1 648 831 2187
maria.heviaalvarez@ey.com

Corin Hobbs
San Jose, CA
+1 408 947 6808
corin.hobbs@ey.com

Deirdre Hogan
San Francisco, CA
+1 415 894 4926
deirdre.hogan@ey.com

Howard Lambert
Irvine, CA
+1 949 437 0461
howard.lambert@ey.com

Steve Patton
New York, NY
+1 212 773 2827
steve.patton1@ey.com