Indirect Tax Briefing

A review of global indirect tax developments and issues

Issue 12 | August 2015
To meet the challenges of doing business in a complex and rapidly changing environment, business models are changing, creating new challenges for tax administrations and tax systems.

Gijsbert Bulk
Global Director — Indirect Tax

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Indirect Tax Briefing is published by EY.

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In this edition, we start by looking at three megatrends that are shaping our modern world – transparency, technology and talent – and consider how they impact indirect taxes. To meet the challenges of doing business in a complex and rapidly changing environment, business models are changing, creating new challenges for tax administrations and tax systems as well. In keeping with this theme, we include an article on 3-D printing and ask how indirect taxes can deal with a radically altered supply chain from both a VAT and customs duty perspective.

We also take a closer look at four trends that are shaping the global indirect tax landscape. Indirect taxes continue to grow and broaden their base. In addition to our regular global indirect changes map (pages 24 and 25), we also include a map that highlights countries and regions that have recently introduced VAT/GST systems, are developing these systems or are undergoing major changes (pages 68 and 69). A further map looks at some of the countries that have announced changes or are reviewing the taxation of the digital economy (pages 34 and 35). These maps provide a high-level overview of significant developments in indirect taxation around the globe, but it is not an exhaustive review. Our article on the GST rollout in India provides an update on the progress of GST introduction and outlines a number of ways in which businesses can be prepared for the many changes GST will bring.

Governments across the globe are continuing to look for ways to increase revenue to finance their budgets, with indirect tax at the forefront. It’s not just the traditional VAT/GST and global trade changes that are affected. We feature specialty indirect taxes—insurance premium tax and environmental and energy taxes—looking at recent changes in these areas and asking how businesses can meet the challenges of compliance and grasp the opportunities that these indirect taxes present.

Tax compliance is a major concern for businesses across the globe. Getting everything right all the time and in every country is a tall order, especially as rules change frequently and are not uniformly applied, even across single-market trading blocs such as the EU. We look at compliance challenges in a number of countries, including the tour operators’ margin scheme in the VAT return form in Russia.

Compliance failures, complex legislation and new tax rules often lead to problematic tax audits and disputes with tax administrations. We provide an overview and key messages from our recent report Managing indirect tax controversy: dealing with audits and disputes,¹ which examines challenges business face in managing controversy around the world as tax administrations focus more attention on enforcement activity.

¹ ey.com/indirectcontroversy
Welcome to the 12th edition of our *Indirect Tax Briefing*.

This is my first edition as EY’s Global Director of Indirect Tax! I am very excited about taking on this role at what I believe to be a crucial moment. Indirect taxes such as VAT, GST and customs duties are playing an increasing part in the global economy, and they are being influenced and changed by global events and developments in technology.

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We also continue our series of articles on trading in Africa, turning our attention to the southern African trading blocs this time, focusing on the future of these alliances and the benefits to businesses in this area.

With regard to global trade, we provide an update on the modernization of the EU Customs Code and focus on customs valuation items. These changes may have a major impact on the customs valuation of imports, making them relevant for numerous exporting businesses around the world that trade with the EU.

We hope that you find this publication informative, useful and relevant to your business. We welcome your feedback. I can be contacted by email (gijsbert.bulk@nl.ey.com) or by telephone (+31 88 40 71175).

Best regards,

Gijsbert Bulk
Global Director — Indirect Tax
Transparency, technology and talent are three factors that are shaping our modern world. Each of these megatrends is transforming how and where we do business and is influencing and shaping economic growth and government policies around the world. Not only are they affecting the world of business—they are also having a powerful effect on the tax function. In this article, we look at how these trends are changing the indirect tax landscape and discuss how businesses might navigate the likely impact on indirect taxation of these trends and the changes they bring.

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Transforming business

We are living in an age of intense business transformation that is having a significant impact on indirect taxes. Business has become more globalized in the wake of the global financial crisis. That global expansion has disrupted supply chains and trade flows and reordered consumer patterns. The downturn sent businesses in search of new markets even as they undertook finance transformations designed to help them grow in a controlled manner, improve profitability and operate more efficiently.

Today, businesses continue to create leaner cost structures and develop more accurate data analytics and forecasting tools to assist with decision-making and risk management, and they are investing heavily in technology to do so.

Every one of these changes has far-reaching implications for the modern tax function. In particular, we have seen a fundamental shift in recent years in how and where companies do business, how they go to market, and how they design their supply chains and business models. Throughout, the tax function has played a front-line role in helping to manage and address the significant tax risks that can arise from the changes that develop from operating globally in a complex and rapidly changing environment.

Let’s explore each of these megatrends and their impact on indirect taxes in more detail:

Technology

Everything about your taxes—and, for that matter, your business—is becoming more transparent than ever. Tax administrators are increasingly taking advantage of data analytics to get behind the numbers reported on the tax return, and they are sharing information and knowledge with one another like never before.

A significant development in this area are the transparency proposals in the OECD Base Erosion and Profit Shifting (BEPS) project, in particular the adoption of the country-by-country reporting and transfer pricing master file templates. These transparency measures will become a reality in the near term.

This level of visibility represents a huge change; tax administrations will effectively go from using a microscope to examine in-country tax returns to using a wide-angle lens, able to see what businesses are telling other governments.

Transparency is not only about direct taxes. We are seeing a strong trend for VAT and GST administrations to exchange information and for them to routinely request information about taxpayers’ activities, not just from companies themselves but also from their suppliers and customers. And the BEPS project will also have an impact; the country-by-country reporting template, for example, will require companies to think about how their taxes are perceived in a new way. Many taxpayers may decide to place more emphasis on their company’s indirect tax payments and remittances to better illustrate the total tax picture and to emphasize their overall revenue contributions. And tax authorities may start inquiries on indirect taxes just as well.
The second major trend is the rapid pace of technology. It is hard to underestimate the importance of the role that technology has played in business transformation and transparency. Only 40 years ago, the fastest supercomputer in the world cost US$5 million to build; today, you can buy a smartphone with more computing power for less than US$1,000.

There are now more than three billion internet users globally; over the next decade, between two and three billion more people will get online as access becomes cheaper and more mobile. Businesses will be able to reach billions of consumers in Africa, South America and Asia for the first time. As they do so, they will meet a host of indirect tax issues that they will need to address quickly or they risk severe business disruption and losing out to their competitors.

Technology is changing the demands on what information companies need to provide and how they should provide it. The importance of indirect tax revenues to governments is driving the tax administration's emphasis on enforcement. And developments in technology are also changing how tax authorities conduct their business — e-audits are becoming the norm. Many jurisdictions are making e-invoicing and e-filing mandatory for businesses. Tax administrators are also leveraging technology in new and sophisticated ways. This technological infrastructure will affect tax law enforcement for decades to come, and business tax functions need to be able to engage on a level playing field.

The technologies that are rapidly transforming business are also challenging the very structure and nature of indirect taxes. The challenge of applying tax to digital services, for example, has triggered new VAT rules in a growing number of countries, including the EU, Norway and South Africa, and continues to do so. Other technologies will be equally disruptive in the market. They are too numerous to mention, but one of the most significant is the 3-D printer. They are fundamentally transforming manufacturing and doing so in such a rapid way that they already cost 90% less than they did four years ago. What does this have to do with indirect tax?

Consider the case of the tax-free dental prosthesis. Imagine a dentist in Dubai ordering a prosthesis for a patient designed and manufactured by a German laboratory. In the past, the German company would manufacture the prosthesis and ship it to Dubai. Now, they can lease the dentist a 3-D printer and send the design via email. The dentist sources the raw material locally and prints the prosthesis himself. And there's no VAT or customs duty, because Dubai doesn't yet have a VAT and Dubai's customs duties don't apply to services.

### Talent

The third and final trend that is shaping the world of tax is talent and the impact of shifting workforces. Fundamentally, there is now more demand for labor than there is available talent. Both governments and businesses are wrestling with this gap. The way that companies manage their human capital in the digital age is becoming riskier from a tax perspective as well. For example, a tax tribunal in India has accepted an employee's social media profile as proof that the company has a permanent establishment there.

Changing demographics are also affecting the shifting outlook for talent. By 2020, 13 countries worldwide will have at least 20% of their population aged 65 or older. A decade later, that number of countries will nearly triple to 34. This isn't just a US and Europe issue. The list of "super-aged" countries includes Argentina, Brazil, Chile, China and Russia. And, of course, Japan is the oldest country in the world, relative to its population age.

More important for businesses, a decade from now only two regions in the world will have a surplus of worker supply: the continent of Africa and India. Businesses will have to decide how to best leverage that talent. Do they shift operations to where the people are? What kinds of infrastructure investments need to happen first? How will consumer demand shift?

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What do these megatrends mean for the indirect tax function?

We have looked at many of the external dynamics, including the global economy and the regulatory environment. All of them raise fundamental questions about the future role and design of tax and how taxpayers can meet their obligations most effectively.

Many internal influences are also shaping the in-house tax function in terms of strategy, enterprise and governance. For example, there is intense competition for tax talent, especially as employee mobility increases with globalization. And many businesses are evaluating their levels of tax risk to minimize controversy as policies change quickly and enforcement rises. At the same time, many businesses are trying to do more with less and are undergoing finance transformations, using technology to automate more of their tax processes and using more integrated compliance and reporting methodologies.

To thrive in this fast-changing environment, tax executives need to think in terms of the role that indirect taxes play in their companies’ wider business plans. And any good plan lays out steps that can begin today to meet a future goal. Here are a few things that you may consider working on now:

1. It starts with talent
   Find and retain the right people to succeed in today’s global business environment. The more your business can do to expand its talent pool, the more successful it will be. Look for people in places that may not have been considered previously and train them well, especially in the emerging or frontier markets that your business wants to penetrate. Having the right people in the right place at the right time is critical.

2. Actively engage on tax policy
   Let’s then look at the “what.” Change is coming – both to the business environment and to tax. There is no use denying this truth, and delaying preparations is a bad idea. Companies that actively engage in the volatile tax policy environment will fare better than those that stay out of the debate.

3. Communicate and manage tax risk
   Act. This is an unprecedented time for tax risk. EY’s fifth Tax Risk and Controversy Survey recently identified four principal drivers of tax risk: reputation risk, enforcement risk, legislative risk and operational risk. They all have a strong connection to indirect taxes.

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2. The survey is available at ey.com/taxrisksseries.
In fact, indirect tax was identified as the second-highest source of risk for our survey respondents, behind transfer pricing. And the survey found a particular disconnect in many businesses when it came to claiming responsibility for indirect taxes, with overlap between different corporate functions.

Indirect tax perceived as second highest tax risk

Is your business ready to level the digital playing field? Leading companies are making investments in tax data enablement and direct and indirect tax technology so they understand their own tax positions better and identify their weaknesses before others do. Technology is an important driver in any discussion about how you manage tax, and tax needs to be part of any technology discussions in your business.

Transparency, technology and talent are transforming the world of business. As companies are changing how and where they operate, tax administrations and tax systems are also transforming. In-house tax functions are navigating the impact of these changes and facing difficult questions and significant tax risks from operating globally in a complex and rapidly changing environment. In this environment, tax executives must start getting involved in strategic decisions that affect the whole business. Companies that address the tax challenges proactively will be best placed to seize the exciting business opportunities that these three megatrends present.

Your business needs to make sure that you have the right resources, processes and technology to manage the many sources of indirect tax risk.

4. Invest in technology

Let technology support your strategic steps. Big data is here. Tax administrations are collecting more data, and they are making huge strides in using it. As a result, they are more empowered than ever to scrutinize the tax positions of companies. And soon, disclosure to one authority will mean disclosure to all.
Other views and analysis from EY’s tax professionals

Managing indirect tax controversy: dealing with audits and disputes
Our digital report *Managing indirect tax controversy: dealing with audits and disputes* can help your organization to navigate the indirect tax landscape. Discover how.

[ey.com/indirectcontroversy](ey.com/indirectcontroversy)

Managing tax transparency and reputational risk
This report, the third in a series of issue-based reports, looks at how companies can manage the reputational risk posed by the debate over who’s paying a “fair share” of taxes. This report shares six tactics with you.

[ey.com/taxriskseries](ey.com/taxriskseries)

Worldwide VAT, GST and sales tax guide
Our *Worldwide VAT, GST and sales tax guide* helps you understand how indirect taxes will affect your company abroad. Chapter by chapter from Albania to Zimbabwe, this guide summarizes consumption tax systems in 114 jurisdictions and the European Union.

[ey.com/vatguide](ey.com/vatguide)

TradeWatch – Global trade
*TradeWatch* is our global trade quarterly publication that spotlights customs valuation developments and also includes global trade updates from countries and regions around the world.

[ey.com/globaltrade](ey.com/globaltrade)

Indirect Tax in 2015
Our annual roundup of global indirect tax developments, including value-added tax (VAT), goods and services taxes (GST), consumption taxes, excise duties, customs duties and other indirect taxes. *Indirect Tax in 2015* updates and details developments in over 100 jurisdictions. These include changes in tax rates, the introduction of new taxes and additions to the growing network of free trade agreements.

[ey.com/indirecttax2015](ey.com/indirecttax2015)

Tax Insights: tax policy in developing economies
From doing business in developing countries to managing tax controversy risks worldwide, our latest edition examines emerging tax policies and trends.

[ey.com/taxinsights](ey.com/taxinsights)
Indirect tax developments in 2015 and beyond

The indirect tax world is in constant motion. What was true yesterday or even today may prove to be wrong tomorrow. Ignoring recent developments in indirect taxes or not being compliant with indirect tax obligations has definitely become an expensive oversight for companies of all sizes, whether they are active in the local market or on a global level.

This article discusses the latest trends and developments in indirect tax around the world and what business leaders should watch for in 2015 and beyond.

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Four trends that shape the global indirect tax landscape:

01. Indirect taxes continue to grow while direct taxes stagnate
VAT/GST systems are spreading, VAT/GST rates are rising and excise taxes are increasing on an almost global scale.

02. Indirect taxes are adapting to new economic realities
E-commerce and virtual currencies are on the radar of an increasing number of governments, and they are adapting their tax systems to capture these transactions.

03. The global trade landscape is changing fast
Global trade continues to grow but still faces trade-restrictive measures in many regions of the world.

04. Tax authorities are focusing on enforcement of indirect taxes
New tools and rules are simplifying tax authorities’ access to taxpayer data and increasing the frequency, efficiency and effectiveness of tax audits.
Indirect taxes continue to grow while direct taxes stagnate

In the aftermath of the financial crisis, governments in many countries still have a strong need for cash. Whether the need is to finance targeted stimulation programs for the economy, or whether it is to make up for the gaps left behind by a shrinking economy, indirect taxes have proven to be the first choice for generating revenue for a number of years. And they continue to be.

This trend can be explained by the large number of prominent advocates that promote the shift from direct to indirect taxes, such as the International Monetary Fund (IMF), the OECD and the European Commission. A number of international studies have indicated that VAT systems have the least impact on growth, while corporate income taxes have a negative impact on growth.1

An equally strong reason for this ongoing development is that international tax competition and the weakened economy simply do not allow for ever-increasing corporate or personal income taxes. Indirect taxes, which by their definition are borne by the consumer and do not rely on profits, are much less affected by these changes. In this context, the results of a recent research paper on the tax situation of the 28 European Union Member States2 are striking: they increased their VAT rates at the same pace as they reduced their corporate and personal income tax rates (see Figure 1).

In practice, we can see three main ways that indirect taxes are used to generate more revenue:

Figure 1. Evolution of standard VAT rates and of the top personal income tax (PIT) and corporate income tax (CIT) rates in the EU-28 (simple arithmetic average)3

2. Austria, Belgium, Bulgaria, Croatia, Republic of Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the UK.
1. VAT/GST systems are spreading

According to the OECD’s “Consumption Tax Trends 2014,” 164 countries in the world levied a VAT as of 1 January 2014: 46 in Africa, 1 in North America, 18 in Central America and the Caribbean, 12 in South America, 28 in Asia, 51 in Europe and 8 in Oceania. As a result, only a minority of countries now apply retail sales taxes, i.e., single-stage taxes on goods and services supplied by final consumers.

Furthermore, the number of “VAT countries” continues to grow, especially in emerging economies. Effective 1 January 2015, VAT was introduced in the Bahamas. Effective 1 April 2015, a GST was implemented in Malaysia to replace the existing sales and services tax. Egypt is considering introducing a VAT law that will replace the existing general sales tax system. Suriname is also expected to replace the current Turnover Tax with a VAT system from 1 January 2016. Last year, the Government of Puerto Rico commissioned a task force to develop a tax reform package that would increase general fund revenue, simplify overall compliance and promote economic growth. Among the reforms discussed in the tax reform package was the implementation of a VAT system. On 29 May 2015, the proposal to implement VAT from 1 April 2016 was approved by the legislative assembly, making Puerto Rico the first US jurisdiction to adopt a VAT system. Perhaps most significantly, India will also soon join the “VAT club.” The Indian Government has been working on replacing the current indirect tax regime with a comprehensive GST, with a current proposed date for introduction of 1 April 2016. However, delays in passing the Constitution Amendment Bill enabling the introduction of GST mean that the proposed implementation date of 1 April 2016 is not likely to be met. When GST implementation goes ahead, this will be a significant development given the size of the Indian economy.

2. VAT/GST rates are rising

In countries where a VAT/GST already exists, average VAT/GST rates have increased in recent years, and those increases seem set to continue. This upward rate trend is particularly true for Europe and the OECD countries, where the average standard VAT rate has now reached 21.6% (EU Member States) and 19.2% (OECD Member Countries), compared with 19.5% and 17.5% average rates, respectively, before the crisis in 2008.

Compared with previous years, the rates in Europe have been surprisingly stable at the start of 2015, although they remain high. Iceland even reduced its standard rate from 25.5% to 24% (while increasing the reduced rate from 7% to 11%). However, there have been some increases. Luxembourg raised its standard rate from 15% to 17%, which is also the reason why the average EU standard rate is still increasing. And new rate increases are likely on the horizon: Italy is considering a rise, and Greece, as part of the European Stability Mechanism, has followed suit.

Figure 2. Average standard VAT rate in the 28 EU Member States and the OECD Member Countries

![Average standard VAT rate](image)

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4. Situation is shown on 1 January of each year. The accession of new Member States to the EU also has an impact on the development of the graph.
For the OECD countries, the main reason for the increased average is because of the consumption tax rate increase in Japan from 5% to 8% in April 2014. Again, this trend is likely to continue, with the already scheduled next increase in Japan due in 2017. Other than Europe and the OECD countries, the VAT rate development is more stable. In contrast to Europe, Angola, Peru and Sri Lanka all lowered their standard rates.

3. Excise taxes are increasing

A truly global trend that leads to higher indirect tax revenue is the increase of excise taxes. Excise taxes on tobacco have increased or will soon increase in many countries, including Denmark, Ecuador, Finland, Ghana, Ireland, Malta, the Netherlands, Norway, Russia, Slovenia, Sweden and Tanzania. Excise taxes on alcohol have increased in Lithuania, Norway and Tanzania, for example. And mineral oil excise taxes have been increased in China, Estonia, Finland, Gambia, Hungary, Norway and Russia.

Not only are the rates increasing, but governments are being creative in inventing new taxes. For example, a relatively new trend is the introduction of excise taxes on health-related products (other than alcoholic beverages and tobacco products), such as snack taxes and sugar taxes on “unhealthy” food.

In many countries, these taxes may be linked to spending on health and welfare, and they may become more widespread as populations age and the pressures on government spending in these areas increase.

In addition, there are still attempts to increase the tax burden on financial transactions, although there is no common global approach to achieving this. Some countries have increased the supervision of the banking industry and tightened regulations. In Europe, the preferred approach has been to levy taxes on financial transactions. France introduced a financial transactions tax (FTT) in August 2012, and on 1 January 2013, Hungary introduced a tax of 0.1% of the amount concerned in the course of any payment service. Italy followed with a tax on the transfer of shares and derivatives and high-frequency trading in March 2013. However, the plan of 11 EU countries to introduce a common transaction tax on the exchange of shares and bonds and on derivative contracts (FTT) is further delayed. The 11 participating Member States have now agreed to launch the tax on 1 January 2016.

Indirect taxes are adapting to new economic realities

One of the peculiarities of indirect taxes is that they are very strongly intertwined with the economy. Their tax object usually is an economic transaction, such as the sale of a good or the provision of a service. If the nature of these transactions or the way that such transactions are handled changes, this immediately has a strong impact on indirect taxation.

The challenge of e-commerce

A striking example of such a change that has disrupted indirect taxes is the boom of e-commerce. E-commerce may be defined as trading in products or services using computer networks, such as the internet. In the mid-1990s, the internet became widely available. The world started to be only “one click” away. This change had a huge influence on the behavior of consumers, as it became possible to buy a
A wide range of goods online without going to a store. It further enabled consumers to purchase services from abroad without paying VAT that would have been levied on the same services purchased locally.

Over the last few years, e-commerce has been the fastest-growing sector in many countries. It is expected that the internet economy will account for 5.3% of GDP in the G-205 countries in 2016 (see Figure 3).

Such an important development implies big changes: it can lead to a distortion of competition between local vendors and foreign vendors, and it can have a significant impact on VAT revenues, particularly in relation to scenarios involving sales to final consumers (B2C transactions).

The international community reacted quickly to this new reality, and already in 1998, the OECD Member States agreed on the Ottawa principles on the taxation of e-commerce:

- Rules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction where consumption takes place.
- An international consensus should be found on which supplies are held to be consumed in a jurisdiction.
- For the purpose of consumption taxes, the supply of digitized products should not be treated as a supply of goods.
- Where a business acquires services and intangible property from suppliers outside the country, countries should examine the use of reverse charge, self-assessment or other equivalent mechanisms.
- Countries should develop appropriate systems to collect tax on the importation of physical goods, and such systems should not impede revenue collection and the efficient delivery of products to consumers.

Figure 3. Rapid development of the internet economy

The internet economy will account for 5.3% of GDP in the G-20 countries in 2016.

<table>
<thead>
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<th>Country</th>
<th>GDP$ Trillions</th>
<th>GDP%</th>
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<td>Turkey</td>
<td>1.3</td>
<td>2.4%</td>
<td>16.5</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1.5</td>
<td>1.3%</td>
<td>16.6</td>
</tr>
</tbody>
</table>

However, the taxation of electronic services remained a patchwork in most countries. In recent years, governments around the world have become active in implementing new rules, realizing that incomplete legislation causes significant losses in revenue.

Recent examples of how the digital economy is influencing VAT law include changes in the EU that introduced new rules as of 1 January 2015 for the place of supply of B2C electronic services. These services are now subject to tax where the customer is established or resident (instead of where the supplier

5. Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, the United States and the European Union.

is established), which requires foreign service providers to register and pay VAT in the EU Member State of the consumer. But it is not just in the EU that the changes are being felt; similar rules have been or will shortly be introduced in Albania, Angola, Japan, South Africa and South Korea. A number of other countries, including Australia, Canada, Israel and New Zealand, are considering changes for non-established suppliers of these services.

The United States faces specific challenges in this regard. US states apply their own consumption taxes, most of which are single-stage taxes on the sale of goods. In order to keep up with the rapid development of the internet economy, a number of states and the federal government successfully enacted legislation that requires “remote sellers” (e.g., vendors who sell taxable goods to customers in other states) to collect and remit tax on multistate sales. Even more recent is the trend to apply sales and use taxes to transactions involving non-tangible goods (e.g., remote access and electronically delivered software, digital music and books). Equally important, the treatment of specified IT service transactions, including data processing, cloud computing and information services, continues to face scrutiny from state lawmakers. And a number of states have announced that they are considering expanding their sales and use tax laws to cover a wide range of service transactions. Most notably, lawmakers in California, in late 2014, announced that they would seek to tax nearly all service transactions within the state (except health care and education-related services) to offset a proposed decrease in the personal income tax rate. It remains to be seen if such measures will succeed.

Virtual currency

Another interesting development in the digital age is the use of virtual currencies, such as bitcoin. Although it is clear that the use of these currencies to conclude transactions triggers many VAT/GST questions, only a very few tax authorities have clear views on how they should be treated. The Australia, Singapore and UK tax authorities have issued guidelines on the VAT treatment of bitcoins and other crypto-currencies.

According to current guidelines, in Australia, bitcoin transactions are treated like barter transactions with similar taxation consequences. From a GST perspective, businesses need to charge GST when they supply bitcoins, and they may be subject to GST when receiving bitcoins in return for goods and services. In the UK, income received from bitcoin mining activities is generally treated as outside the scope of VAT because the activity does not constitute an economic activity for VAT purposes. Income received by bitcoin miners for other activities will generally be exempt from VAT, as are charges over the value of the bitcoin for arranging transactions. In Singapore, virtual currencies are treated as a supply of services for GST purposes, which do not qualify for GST exemption.

It appears that the positions being adopted by these different countries are not consistent, and that pattern may be expected to continue. Some countries have banned bitcoins outright (e.g., Russia and Vietnam). Furthermore, other country tax authorities are currently assessing the tax treatment, and additional country-specific guidance is expected going forward (from both an indirect and direct tax perspective). This lack of global consistency may lead to a number of challenges for businesses operating in this market.
The global trade landscape is changing fast

While everyone agrees on the importance of free trade to boost the global economy, the reality shows a different picture. According to data of the World Trade Organization (WTO), the G-20 countries adopted 1,244 trade-restricting measures since October 2008, but only 282 have been removed in the same period. During the most recent observation period from mid-May to mid-October 2014, 93 new measures have been adopted that affect around 0.8% of the value of G-20 merchandise imports and 0.6% of the value of world merchandise imports. Consequently, while governments are counting on exports for growth, they are at the same time restricting imports. This requires businesses to plan very carefully.

On the positive side, it should be mentioned that countries are negotiating measures to facilitate trade. G-20 economies applied 79 trade-liberalizing measures between May and October 2014. In terms of trade coverage, import-liberalizing measures account for 2.6% of the value of G-20 merchandise imports and 2% of the value of world merchandise imports. This amounts to close to US$370 billion — almost three times the trade value of the new trade-restrictive measures. In late 2014, the US and India resolved an important impasse over the implementation of the WTO Trade Facilitation Agreement (TFA) reached in Bali in December 2013, paving the way for full implementation of the TFA, which will enter into force once two-thirds of members have completed their domestic ratification process. The OECD Trade Facilitation Indicators estimate that comprehensive implementation of all measures contained in the agreement would reduce total trade costs by 10% in advanced economies and by 13% to 15.5% in developing countries.

In addition, the number of free trade agreements (FTAs) that are negotiated and signed steadily increases. The WTO currently reports 604 active and pending reciprocal regional trade agreements among its members. This number does not include unilateral preference programs, i.e., trade preferences granted to products imported from identified countries without reciprocal benefit, such as the Generalized System of Preferences (GSP) in the EU and the US, which provides duty-free treatment to many products from developing nations. Just a few examples of important, recently signed or effective agreements are the FTA between South Korea and Australia (entered into force December 2014), between Canada and South Korea (effective January 2015) or the rules of the Gulf Cooperation Council (GCC) Customs Union (effective January 2015). Negotiations are progressing on two very significant FTAs, the Trans-Pacific Partnership (a 12-country agreement) and the Transatlantic Trade and Investment Partnership (between the EU and the US). The Trans-Pacific Partnership could well be concluded this year.

Despite the growing number of FTAs, in many cases, businesses are not actually obtaining the potential benefits offered by FTAs because they cannot or do not meet the qualifying conditions. More generally, consistent with the protectionist environment still present in the global economy, many countries strictly enforce the FTA conditions, causing businesses that cannot substantiate FTA claims to pay import duties at the general rate. Where countries are not bound by FTAs, import duties are still a common and often-used means to steer trade and production development.

Although customs duty rates are generally reducing, these taxes still play a very significant role in meeting countries’ budgetary needs. In many cases, duty rates are high and duties form part of the cost base of affected goods, because duties charged at one stage in the supply chain are not offset against taxes due at later stages (unlike VAT/GST). In constant search for revenue, countries have started to focus increasingly on the customs tax base. There are attempts to increase the base, like eliminating the first-sale concept and tightening the definition of dutiable royalties. This is reflecting a global trend, and the result could be that royalties and service fees will have to be added to the value of imported goods to properly reflect their value, thus enlarging the customs tax base.

Also on the more practical side, many countries are making changes to their customs legislation that reflect a number of these trends. In the EU, for example, the legislation that governs customs activities is currently being rewritten as the Union Customs Code (UCC). This new code is due to come into force in May 2016. The UCC eliminates the earlier sale rule and tightens the definitions of royalties, which directly impact the tax bases. At the same time, it will entail profound changes to some customs regimes and controls that should facilitate trade, such as:

1. The introduction of Self-Assessment and Centralized Clearance
2. Mandatory guarantees for special procedures and temporary storage
3. The ability to move goods under temporary storage rather than national transit or New Computerized Transit System (NCTS)
4. All communications between customs authorities and economic operators must be electronic

Tax authorities are focusing on enforcement of indirect taxes

Tax audits are changing. Tax and customs inspectors are increasingly using modern technology tools to access real-time comparative figures and data when auditing businesses. They are sharing more information, and more and more tax administrations around the world are implementing electronic auditing of businesses’ financial records and systems. In many cases, taxpayers’ information is under scrutiny even without an on-site audit taking place.
A recent survey carried out among EY indirect tax professionals based in 82 countries revealed that the tax authorities in 59 of those countries use electronic data extraction to perform tax audits (see Figure 4). In 72 countries, the tax authorities conduct off-site audits using data submitted by the taxpayer (such as customs declarations, VAT/GST returns and lists of transactions) (see Figure 5).

The benefits for tax administrations are clear: the more efficient use of technology lowers costs of collection and compliance and increases the amount of errors detected. In addition, tax and post-importation audits are becoming much harder to deal with for those companies that are not well prepared. On the flip side, knowledgeable and prepared taxpayers may also find it easier to deal with more professional tax and customs administrations.

These developments in technology and e-auditing are also paving the way for mandatory electronic invoicing and electronic filing of tax returns, which are fast becoming the global norm. Bolivia, Indonesia, Italy and Spain all recently made mandatory electronic invoicing for larger transactions or for transactions involving specific recipients, particularly public bodies.

Figure 4. Do the tax authorities use electronic data extraction to perform tax audits?

Figure 5. Do the tax authorities conduct off-site audits using data submitted by the taxpayer (e.g., customs declarations, VAT/GST returns)?

9. Angola, Armenia, Aruba, Australia, Austria, Belarus, Belgium, Bolivia, Bonaire, Sint Eustatius and Saba (BES Islands), Botswana, Brazil, Bulgaria, Canada, Chile, China, Costa Rica, Croatia, Curacao, Cyprus, Czech Republic, Denmark, Ecuador, El Salvador, Equatorial Guinea, Estonia, Finland, France, Georgia, Germany, Ghana, Greece, Guam, Guatemala, Hungary, India, Indonesia, Ireland, Italy, Jamaica, Japan, Jordan, Kazakhstan, Kenya, Latvia, Lithuania, Luxembourg, Macedonia, Malawi, Malta, Mexico, Namibia, Netherlands, New Zealand, Nigeria, Norway, Pakistan, Papua New Guinea, Paraguay, Peru, Poland, Portugal, Puerto Rico, Romania, Russia, Singapore (including Brunei), Sint Maarten, Slovak Republic, Slovenia, South Africa, South Korea, Spain, Suriname, Sweden, Switzerland, Thailand, Trinidad and Tobago, Turkey, Uganda, UK, Ukraine, Uruguay, Zambia.
What do these trends mean for your business?

All of the development trends identified in this report have a direct impact on business activities; however, not all of them may have a direct impact on your organization. Use the developments outlined in the detailed report to help you identify which are relevant for your sector and the countries where you operate and what they mean for your management of tax risk and your overall business strategy.

Confirming that the latest changes and developments in a country’s legislation have been correctly implemented into your ERP system is essential to ensuring accurate local compliance. The importance of accuracy increases as indirect tax rates increase, because the consequences of applying the wrong rate become more severe.

The impact of rising VAT/GST rates is particularly significant for businesses that do not recover VAT/GST in full (e.g., because of VAT exempt activity), such as banks and insurance companies. Higher rates also have an increased cost or cash flow impact on companies that incur VAT/GST in foreign jurisdictions that is not refunded quickly or that they do not or cannot recover (e.g., because of an absence of refund schemes for nonresidents or because of complicated refund procedures).

Our experience shows that many companies still pay too much indirect taxes, often because they do not identify and manage these duties and their associated costs effectively. For example, many companies are not aware of exemptions or refund schemes that they may qualify for, e.g., for energy taxes. Many global companies could save large amounts in customs duty costs, sometimes amounting to millions of dollars, by making small changes in their supply chains to meet the qualifying conditions of FTAs. Similarly, small changes to how or where you do business may reduce your number of VAT/GST registrations and the related compliance risks.

Companies that operate in the digital economy are directly affected by the increasing trend to tax these activities. If your business involves running webshops or providing electronic services to final consumers, such as telecommunications, content download, information provision or broadcasting services, these developments should be focused on.

Have you clarified your current indirect tax liabilities in the countries where your clients reside? Do you know which countries are planning to introduce taxation and the form it will take?

Tax administrations are turning increased attention to enforcement of indirect taxes, and they have new and powerful audit tools at their disposal. Taxpayers need to be prepared to meet higher standards of transparency. Increased audit activities and scrutiny may disrupt business and lead to unexpected liabilities. Reputational risk is also a danger. Large assessments for underpaid tax or penalties for late filings not only have an impact on profitability, they may draw unwanted adverse publicity, even for compliant businesses.

More than ever, it pays to proactively manage indirect taxes. Establishing a clear indirect tax strategy will help you keep your business up to date with the rapidly changing tax environment.
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Indirect tax changes: global update map

In this, our regular high-level overview of indirect tax changes around the world, we outline some of the indirect tax changes (agreed upon and proposed) that have taken place since the start of 2015 and developments that we are aware of that are due to take place later this year and beyond. These changes supplement those set out in our report titled, Indirect Taxes in 2015, and in previous editions of Indirect Tax Briefing, both available online at ey.com/indirecttax.

We are continuing to see a great deal of indirect tax changes around the world, especially in connection with VAT and GST. These consumption taxes are continuing to spread, with a number of countries announcing plans to introduce a VAT or GST system or extend the scope of their VAT system to new activities. At the same time, many countries are introducing new VAT or GST rules for taxing the digital economy. These specific changes are highlighted separately in other maps in this publication —see pages 68 and 69 for changes regarding new or developing VAT systems and pages 34 and 35 for changes relating to the digital economy.

- **Iceland**
  - January 2016: reduced-rate VAT will apply to passenger transportation for recreational purposes and services provided by travel agents and travel organizers (currently exempt)
  - January 2016: reduced VAT rate will apply to admissions to spas and bathhouses (currently exempt)

- **Luxembourg**
  - May 2015: standard rate VAT (17%) applies to digital or e-books

- **Spain**
  - January 2017: new reporting system for invoices will come into force

- **St. Kitts and Nevis**
  - April 2015: VAT no longer applied on food, medicine and funeral expenses

- **United Kingdom**
  - November 2015: standard rate of IPT will increase from 6% to 9.5%

- **Ukraine**
  - January 2015: electronic VAT administration system implemented for all taxpayers

- **Argentina**
  - July 2015: issuance of electronic invoices has been extended to all VAT taxpayers

- **Chile**
  - January 2016: VAT to be applied to the sale of immovable property

- **Paraguay**
  - June 2015: e-invoice and receipt system implemented
**Czech Republic**

- 1 January 2016: supply of audiobooks on physical carrier media is subject to reduced VAT rate of 7%
- Plans to introduce unified VAT rate of 17.5% from 1 January 2016
- 1 January 2016: requirement for all VAT-registered persons to file VAT ledgers that provide detailed information of all taxable supplies received and effected on a monthly basis

**Greece**

- 20 July 2015: As a result of the European Stability Mechanism, a number of VAT changes came into effect including limitations to goods and services subject to the reduced and super reduced VAT rates, the abolition of favorable VAT rates applicable to Greek islands and exemptions regarding certain educational services measures aimed at an immediate withholding by banks and remittance of VAT due on invoices paid through banks.
- 16 July 2015: standard rate of IPT on most non-life insurance policies increased from 10% to 15%

**Germany**

- 1 January 2015: supply of audiobooks on physical carrier media is subject to reduced VAT rate of 7%

**Italy**

- 1 January 2016: potential standard VAT rate increase to 24% (from 22%), with further potential increases planned from 1 January 2017 (to 25%) and from 1 January 2018 (to 25.5%)
- 1 January 2016: potential reduced VAT rate increase to 12% (from 10%) and to 13% from 1 January 2017
- 1 January 2015: 4% VAT rate applies to e-books (previously 22%)
- 1 January 2015: imposition of customs duties and sales taxes

**Ireland**

- 1 January 2015: VAT rate for all food products, nonalcoholic beverages and food services reduced to 9% (from 24%)
- 1 January 2016: expansion of reduced rate to other products and services
- Before 1 January 2016: VAT rate to be reduced from 24% to 19% (reverting to previous rate)

**Indonesia**

- 1 July 2015: e-invoices required for corporate taxpayers registered in the 17 regional tax offices on islands of Java and Bali
- 1 January 2016: e-invoices to be mandatory for all taxpayers

**Iraq**

- 1 August 2015: imposition of customs duties and sales taxes

**Japan**

- 1 January 2015: supply of audiobooks on physical carrier media is subject to reduced VAT rate of 7%

**Korea**

- 1 January 2015: supply of audiobooks on physical carrier media is subject to reduced VAT rate of 7%

**Kuwait**

- 1 January 2015: supply of audiobooks on physical carrier media is subject to reduced VAT rate of 7%

**Luxembourg**

- 1 January 2015: supply of audiobooks on physical carrier media is subject to reduced VAT rate of 7%

**Malaysia**

- 1 January 2015: supply of audiobooks on physical carrier media is subject to reduced VAT rate of 7%

**Netherlands**

- 1 January 2015: supply of audiobooks on physical carrier media is subject to reduced VAT rate of 7%

**New Zealand**

- 1 January 2015: supply of audiobooks on physical carrier media is subject to reduced VAT rate of 7%

**Philippines**

- 1 July 2015: e-invoices required for corporate taxpayers registered in the 17 regional tax offices on islands of Java and Bali
- 1 January 2016: e-invoices to be mandatory for all taxpayers

**Poland**

- 1 January 2015: supply of audiobooks on physical carrier media is subject to reduced VAT rate of 7%

**Romania**

- 1 June 2015: VAT rate for all food products, nonalcoholic beverages and food services reduced to 9% (from 24%)
- 1 January 2016: expansion of reduced rate to other products and services
- Before 1 January 2016: VAT rate to be reduced from 24% to 19% (reverting to previous rate)

**Russia**

- 1 January 2015: new VAT return introduced requiring additional sales and purchase data

**Singapore**

- 1 July 2015: pre-registration claim rules apply that allow newly GST-registered business to claim pre-registration GST on certain goods and services

**Slovakia**

- 1 January 2016: VAT “cash-accounting” scheme being introduced for taxpayers whose annual turnover does not exceed €75,000
- 1 January 2016: scope of reverse-charge mechanism for goods being extended to all goods supplied by non-established taxpayers

**Slovenia**

- 1 January 2015: supply of audiobooks on physical carrier media is subject to reduced VAT rate of 7%

**Spain**

- 1 January 2015: supply of audiobooks on physical carrier media is subject to reduced VAT rate of 7%

**Sweden**

- 1 January 2015: supply of audiobooks on physical carrier media is subject to reduced VAT rate of 7%

**Thailand**

- 1 January 2015: supply of audiobooks on physical carrier media is subject to reduced VAT rate of 7%

**Turkey**

- 1 January 2015: supply of audiobooks on physical carrier media is subject to reduced VAT rate of 7%

**Ukraine**

- 1 January 2015: supply of audiobooks on physical carrier media is subject to reduced VAT rate of 7%

**United Arab Emirates**

- 1 January 2015: supply of audiobooks on physical carrier media is subject to reduced VAT rate of 7%

**United Kingdom**

- 1 January 2015: supply of audiobooks on physical carrier media is subject to reduced VAT rate of 7%

**United States**

- 1 January 2015: supply of audiobooks on physical carrier media is subject to reduced VAT rate of 7%
3-D printing: how will indirect tax keep up with technology?

We are on the brink of a new industrial revolution, brought about by the advances in technology that are allowing goods to be manufactured and delivered to customers in new ways. The prediction that 3-D printing could radically alter supply chains and move manufacturing closer to end customers raises many interesting business and taxation topics. The question we will address in this article is how will 3-D printing impact indirect taxes?

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What is 3-D printing?

Additive manufacturing, more commonly known as 3-D printing, is essentially the opposite of traditional manufacturing, whereby objects are created by subtraction. A practical example is how a log of wood is sliced, diced and chipped away until the basic parts of a table, bookshelf or chair have been created. By contrast, in 3-D printing, a product is created by adding material. Simply put, a 3-D printer creates a three-dimensional product by adding layer after layer of material until the object is complete. Currently, products are printed mainly using raw materials such as plastics or metals, but even bio-printing and food-printing are developing. In fact, the potential of 3-D printing seems virtually endless, prompting economists to announce the arrival of the Third Industrial Revolution.¹

Although 3-D printing has been around for some time, the technology has only now reached the stage where it is affordable enough to reach a broader market. It is widely anticipated that 3-D printing will quickly revolutionize the way that products are produced because it is as cheap to make one item as to make thousands. This effect is predicted to counteract globalization by moving manufacturing closer to end customers.²

VAT and customs duties

VAT and customs duties are indirect taxes, generally assessed on a transaction-by-transaction basis. Customs duties are typically levied on the importation of physical goods into a territory. VAT/GST and other similar consumption taxes apply to both goods and services and typically apply to domestic as well as cross-border flows. As we will discuss in more detail later, one of the complexities of 3-D printing from an indirect tax perspective is that it can encompass several different types of transactions, such as supplies of goods and services, which may be supplied together or provided separately by one or more suppliers.

From an indirect tax collection perspective, the move to 3-D printing and away from traditional manufacturing can pose quite a challenge to tax and customs authorities. The first challenge lies within the fact that 3-D printing is a fairly new concept, and, as such, has yet to be defined from an indirect tax perspective. Secondly, the impact of 3-D printing on supply chains has the potential to drastically influence indirect tax revenues.

Customized products

Currently, consumers can already order products that are customized by adding 3-D-printed elements. Companies that offer this facility will not only buy and sell products, but also manufacture or at least process products, to some extent. This changes the business model. However, the end product that is sold to the consumer is nonetheless a physical good and should be treated as such from an indirect tax perspective. Therefore, while this development could have a significant impact on the supply chain structure of some companies and, as a result, lead to a degree of increased customs and VAT complexity, we expect that this should be temporary and that the main issue in this context for the seller should be ensuring that it applies the correct VAT coding and reporting.

Home printing

As 3-D printers become more affordable and widely available, more consumers are expected to buy the raw materials and print their own products using the design instructions that can be purchased from retailers, downloaded from peer-to-peer networks or even created by the consumer themselves. How should indirect taxes apply to the supplies of raw materials on the one hand and to the design instructions on the other? In the following sections, we will address this question, as well as how increased home printing will impact tax revenues collected by tax authorities.

How to classify 3-D printing from an indirect tax perspective

Distinction between goods and services

Generally speaking, the traditional definition of a good for VAT and customs purposes depends on whether the object of the transaction is tangible. Generally, if an item does not qualify as a good, it is treated as a service for indirect tax purposes. Simply put, tangible items (such as chairs, computer monitors and apparel) typically qualify as goods, whereas intangible supplies (such as legal advice, data processing and downloaded music) should be viewed as services.

Applying this traditional view to 3-D printing, we would be forced to say that only the delivery of physical items (such as customized goods or raw materials used for printing) should be viewed as goods for tax purposes, whereas the design element needed to create the printed object is something inevitably intangible and should be qualified as a service. Since goods and services are taxed differently, this distinction could have far-reaching consequences for the collection of indirect taxes.

2. The OECD addresses 3-D printing, along with advanced robotics and phenomena such as “the sharing economy,” in its paper “Addressing the Tax Challenges of the Digital Economy, OECD/G20 Base Erosion and Profit Shifting Project,” pp. 61–62, 16 September 2014.
From a customs perspective, the distinction between goods and services is even more critical, because customs duties apply to the importation of goods into a country or territory, but not to services. Usually, the sales price in the country of importation is the starting point to determine the customs value. So, upon importation of a plastic toy, the customs value is likely to include not only the raw material elements of the product but also most other elements that drive the price of the product (e.g., design elements, brand value).

If the end customer were to import only the plastic raw material and obtain the design separately to print their toy at home, then the customs calculation would come to a very different result.

Example 1

In this simplified example of a traditional supply chain, goods are produced by a manufacturer and sold to the end customers via a local distributor. In this example, the goods are delivered from the manufacturer in China to the local distributor in Europe. We can assume that customs duties (nondeductible) and import VAT (deductible for the distributor) are due upon importation of the goods. The onward sale would generally be subject to local VAT (not deductible for a final consumer).
Example 2

In our next example, the same supply chain applies to the raw materials, but a separate design element required for 3-D printing the final product can be delivered to the end customer through a number of different channels. In this example, we have considered the possibility that the local distributor could sell the raw materials and design element separately to the end customer.

As illustrated on the next page, the design element could be downloaded from a peer-to-peer network for free, or a pirated copy can be purchased at a low price, or the rights to the design could even be held by a completely separate design entity, that interacts directly with the end customer. While the customs and VAT consequences for the flow of physical goods should remain the same as in Example 1, the real value of the transaction is likely in the design element, and the key question is how this should be treated from a customs and VAT perspective.

Total taxes collected by EU tax authorities (assuming sample duty rate of 5% and VAT rate of 25%)
Customs duties: 1.25
VAT: 0–50

Assumption made that P2P or Jolly Roger may not charge a fee for the design or may fail to fulfill VAT obligations.
Impact on customs duties

Customs duties should, in principle, be levied only on the physical delivery of goods in both of the above examples. Thus, in Example 2, the customs duties collected would presumably be levied only on the design element. It might be possible to argue that customs duties could be due on the design element as well; however, in our view, this would require a clear connection between the raw material and the design element. This could be the case if, for instance, a company such as a toy manufacturer started selling a very specific type of plastic along with design instructions for customers to print their own very specific building blocks for toys. In this case, it could be argued that the design element should be included in the value of the raw materials when determining the basis for the customs duty assessment.

It seems far more likely, however, that the raw materials bought by the customer could be used to print any number of products. If this were the case, it would be difficult to argue that the value of a potential intangible asset (in the form of design instructions) should be attributed to the raw materials at the time they cross a customs border. Thus, in most cases, the raw materials should be assessed for customs duties on the basis of their face value.

The design itself would presumably be delivered electronically and completely separately from any delivery of physical goods and, as such, would fall outside the scope of customs in most cases. The question of whether the design element could be treated as a “deemed” good should also be considered, but this seems difficult to translate into practical application. Likewise, it does not seem feasible or reasonable to anticipate that the scope of customs duties could apply to services in general.

Implications for VAT collection

At first sight, the VAT amount collected from the final consumer should not differ significantly in the two scenarios. In Example 1, the whole supply from distributor to end customer would be subject to local VAT. In Example 2, local VAT would be levied on the supply of raw materials as well as the design element if both are supplied by the distributor to the end customer. However, in the sub-options of Example 2, where the design element is delivered through other channels, the VAT treatment applied and consequently the VAT amount collected could be quite different, as described below:

• If the design element is delivered from an external design company, it should be fairly safe to assume that it would be provided at market value. If the end customer is domiciled in the EU, VAT should be collected in the customer’s country of domicile on the sales price, in accordance with EU and domestic stipulations. Many non-EU countries now have similar rules.

• If, however, the customer manages to acquire a pirated copy of the design at a heavily “rebated” price, downloads it for free from a peer-to-peer network, or even creates the design themselves, it is quite likely that no VAT will ever be calculated on the value of the design element,3 which is why the anticipated VAT collected in Example 2 results in a rather broad range.

While this discussion has little to do with the question of how the design element ought to be treated from a VAT perspective, it is recognized that the digital economy poses quite a practical challenge to tax authorities in the field of collecting taxes. In the long run, new means may be developed to counteract the reduction of revenue collected by the tax authorities (e.g., through changes to VAT collection systems or increased VAT rates).

Comparable transactions

As 3-D printing is a fairly new phenomenon, it is not easy to find comparative transactions that could offer additional guidance in assessing indirect tax consequences. Some similarities can be found within publishing: books can be purchased in a traditional printed format as well as electronically (and, in some cases, printed at home if the customer wishes). Printed books (as tangible objects) are treated as goods for VAT purposes, whereas electronic books (being intangible) are treated as services.

3. The risk for reduced tax revenues in the digital economy has also been noted by the OECD in its paper “Addressing the Tax Challenges of the Digital Economy, OECD/G20 Base Erosion and Profit Shifting Project,” pp. 19, 47, 133 and 148, 16 September 2014.
As books generally benefit from a reduced VAT rate in the EU, the primary discussion around the VAT treatment of books from an EU VAT perspective has focused on the question of whether books provided on other physical media (e.g., on CDs or memory sticks) can be considered comparable to printed books. While the Court of Justice of the European Union (CJEU) is considering this question, it seems that most legislators have not even begun to consider whether electronically supplied books (i.e., books downloaded online) could also be considered comparable to traditional books. In fact, in its current wording, the European VAT Directive explicitly states that electronically supplied services may not be subjected to reduced VAT rates. In the context of 3-D printing, this is the legislative landscape that sets the current scene for the players and the framework within which they will have to operate and face the challenges and possible opportunities that may come.

Risks and opportunities

Customs duty savings: it is difficult to generalize and anticipate how 3-D printing will impact customs duties paid in actual supply chains. It would, however, be reasonable to anticipate that corporations could reduce their customs duty costs by moving production closer to the end customer, while retaining ownership of the valuable intellectual property rights (i.e., the design element) in a central entity. In such a scenario, it could, in our view, be argued that customs duties should be due only on the raw materials imported by the manufacturing entity, whereas the design element of the finished product should be kept out of the customs duty assessment base. If this position can be upheld successfully with the customs authorities, the overall customs duties paid by the group should be reduced. Furthermore, by keeping the central entity that owns the design rights out of the supply chain of the physical goods, this type of structure could also lead to decreased VAT complexity in comparison with supply chains where the central entity is involved in the supply of physical goods and, as a result, is often required to register for VAT or even set up a branch in jurisdictions where it is not resident.

VAT reporting: as with any supply chain change or new business model, indirect tax reporting requirements must be considered and monitored to ensure compliance. Thus, businesses looking into the opportunities offered by the development of 3-D printing should consider that any changes to their supply chains will require an assessment of the impact on indirect taxes. Businesses that are shifting their focus from selling business-to-business (B2B) to selling to final consumers (B2C), for example, should keep in mind the differences in the VAT treatment and obligations that apply to supplies made to B2C customers compared to B2B customers.

If, for instance, businesses currently producing consumer goods for retailers were to shift part of their business to creating designs for their products that can be downloaded directly by end customers, completely new supply chain structures could be created, and the compliance obligations of the suppliers would be vastly different from those in current structures. In this context, suppliers of electronic services need to keep in mind the EU VAT changes introduced on 1 January 2015 relating to the VAT treatment of e-services supplied to private individuals (B2C). While the aim of the new rules has been to level the playing field between e-service suppliers based in the EU and those based outside of the EU, the effective result of the rules is that B2C suppliers now face more extensive registration and reporting obligations than before.

New taxes: as we see the adoption of 3-D printing speeding up, this trend looks highly likely to have an impact on the amount of tax revenues collected through customs duties. Throughout the financial crisis we have seen that when one source of tax revenue dwindles, governments will look into other options to collect taxes. For example, reductions in revenues from direct taxes have led to increasing VAT rates throughout Europe and to the adoption of a range of excise taxes around the world. It would not be surprising if one indirect consequence of the rise of 3-D printing could be the increase of other taxes – for example, more countries might introduce a “business tax” as applied in China in the past, or a “social security tax” due on services, such as the one applied by Italy.

4. More information can be found in the EY publication Overview of EU VAT changes for digital products and services in 2015.
5. In its 2014 paper “Addressing the Tax Challenges of the Digital Economy, OECD/G20 Base Erosion and Profit Shifting Project,” on page 146, the OECD suggests creating a withholding tax on digital transactions as one potential option to counteract the tax challenges raised by the digital economy.
Conclusions

The tax treatment of 3-D printing poses a number of interesting questions. One thing is clear: 3-D printing will revolutionize manufacturing and supply chains as we know them. Given the rapid developments, we may not even be able to imagine half of the potential of 3-D printing, and we are not currently able to foresee all the potential consequences for indirect taxes. What we can be certain of is that legislators and the tax courts will struggle to keep up with these developments. The practice of how to apply taxes such as VAT and customs duties will have to be invented every day, with every new development.

EU indirect tax implications for 3-D printing

- Customized goods and raw materials for 3-D printers should be treated as goods from a customs and VAT perspective. This means that they should attract customs duties and import VAT when crossing a customs border and be subject to VAT based on the time of supply and place of supply rules for goods.
- Design instructions provided together with specific raw materials for which they are to be used are at risk of being included in the customs assessment base of the raw materials. In addition, VAT may be due on the design instructions, depending on the VAT rules in the country of the consumer.
- Design instructions provided separately from raw materials could be viewed as a service and as such should not be included in the customs assessment base of the raw materials. However, VAT may be due on the design instructions, depending on the VAT rules in the country of the consumer.
- In the short term, 3-D printing could present both challenges as well as opportunities for tax planning, tax accounting and design. Uncertainties about the correct customs and VAT treatment of products, raw materials and supplies could lead to tax controversy. The indirect tax benefits and risks of 3-D printing should be determined based on the circumstances of each individual business.
- In the long term, 3-D printing could lead to decreased customs duty revenue for tax authorities, as well as decreased VAT collection on B2C sales, which could trigger increases in other taxes.
Many countries are introducing new VAT or GST rules for taxing the digital economy. This map highlights a selection of agreed upon and proposed changes relating to the VAT/GST treatment of e-services around the world.

**Turkey**

- May 2015: consultation document issued regarding taxation of digital economy
- Turkey is considering introducing rules for inbound B2C supplies of electronic services

**Canada**

- May 2015: consultation document issued regarding taxation of digital economy

**US**

- Late 2015: implementation of Digital Goods and Services Tax Fairness Act of 2013 expected
- 1 July 2015: Chicago applies 9% Amusement Tax on electronically delivered television shows, movies or videos
Australia
1 July 2017: plans to extend the reach of GST to digital products and services supplied by offshore suppliers to Australian consumers

European Union (EU)
1 January 2015: new rules on place of business-to-consumer (B2C) supplies of e-services, broadcasting and telecommunications were introduced and EU suppliers can use the Mini One Stop Shop (MOSS) to fulfill VAT obligations for services provided in other EU Member States where they are not established

Tanzania
1 July 2015: new VAT act comes into force – new rules for VAT treatment of cross-border, intracompany (e.g., branch-to-branch) transactions, electronic services and imported services (i.e., reverse-charge accounting), and also introduces three-year time limit to correct VAT errors
Reported that Tanzania considering introducing rules for inbound B2C supplies of electronic services

Israel
Draft guidelines issued by tax authorities show they are considering taxation (income tax and VAT) of foreign companies providing digital services

Japan
1 October 2015: consumption tax applies to provision of digital services provided from overseas to Japanese customers
1 April 2017: consumption tax rate will increase to 10% (from 8%), postponed from 1 October 2015

New Zealand
Government considering adding GST to online purchases from overseas suppliers

South Africa
Proposal that software be included in list of electronic services (with registration requirements for foreign suppliers) still being considered

South Korea
1 July 2015: VAT applies to e-services purchased from abroad with foreign service providers required to register with tax authorities

Tanzania
1 July 2015: new VAT act comes into force – new rules for VAT treatment of cross-border, intracompany (e.g., branch-to-branch) transactions, electronic services and imported services (i.e., reverse-charge accounting), and also introduces three-year time limit to correct VAT errors
Reported that Tanzania considering introducing rules for inbound B2C supplies of electronic services

Indirect Tax Briefing – August 2015
Managing indirect tax controversy: dealing with audits and disputes

Knowing the indirect tax rules for your business operations and applying them correctly are key actions in avoiding assessments and penalties. But taxpayers and tax administrators do not always agree on the rules.

Complex local legislation, evolving business models and widely different compliance obligations in different jurisdictions add to the risk of disagreements.

Our latest report, *Managing indirect tax controversy: dealing with audits and disputes*, examines the challenges that taxpayers face around the world. We also outline some leading practices for avoiding and resolving indirect tax disputes and for preparing for successful tax audits. Following are some of the key messages we highlight.

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Managing indirect tax controversy: dealing with audits and disputes

VAT/GST and customs — high on the tax agenda

In recent years, issues related to managing indirect taxes such as VAT, GST, customs and excise duties have risen higher on the corporate agenda. What factors have brought these taxes and duties to the attention of C-suite executives?

External drivers

Indirect taxes are growing in importance as sources of tax revenues and as instruments of governmental policy. As a result, tax and customs administrations are focusing more attention than ever on indirect tax compliance and enforcement.

At the same time, the “fair tax” debate has turned a spotlight on corporations’ tax affairs generally. Initially, attention focused on direct taxes, but now the debate has expanded to include questions such as:

• How should VAT/GST apply to cross-border transactions and the digital economy?
• What is the interplay between customs valuation and transfer prices?

These topics are drawing far greater attention not only from tax administrations but also from regulators, the media and the general public. Large tax assessments can damage corporate reputations as well as profitability.

Internal drivers

Businesses around the world are under pressure to improve financial performance. And they are increasingly aware of the intense scrutiny they face from a range of internal and external stakeholders.

In the process, they are asking more of their tax and finance functions, challenging them to reduce risks and meet the company’s obligations more effectively, using limited resources.

These functions are being asked to go beyond tax compliance and tax accounting. They are being asked to contribute to companies’ financial performance by reducing costs, facilitating processes and improving cash flow.

Increasingly, tax and trade functions are also actively participating in strategic decision processes to provide financial and nonfinancial impact analyses.

Indirect tax controversy matters

The consequences of controversy and the business drivers for avoiding or resolving it are particularly strong for indirect taxes. Getting everything right all the time and in every country is hard.

Errors, uncertainty and disagreements abound, often leading to assessments, penalties and disputes that go far beyond the tax or finance function.

• A dispute with customs may not just be a tussle over taxes — it can mean genuine business disruption: Customs can seize a trader’s goods or shut down operations. Even a delay of a few hours for an unexpected customs inspection can breach contractual conditions for just-in-time deliveries or hold up valuable production schedules.
• Uncertainty over charging VAT/GST can leave the wrong party out of pocket: Most businesses registered for VAT/GST are not the final taxpayers. They collect and remit the tax due from their customers, effectively acting as tax collectors. Not charging tax, or not charging the right amount of VAT/GST at the time of sale, can be costly. If tax is later deemed to apply to the sale and the charge cannot be passed on to the customer, the tax collector can become the taxpayer, funding the VAT/GST out of its profits.
Actively engaging with the tax agenda, anticipating future audit activity and developing a strategy for dealing with controversy can reduce the impact of inspections on day-to-day operations and improve audit outcomes.

Managing indirect tax controversy

Often, there is a lack of clear ownership around indirect taxes, particularly from a compliance or financial statement perspective. No single person or department is responsible for the end-to-end process, and different parts of the business may expect others to pick up the responsibility, resulting in operational gaps.

Tax, trade and finance functions must collaborate in this process to ensure there are no weaknesses or gaps. They must work with one another and with other functions within the organization (for example, legal and IT) and with third parties (for example, customs brokers).

C-suite executives can also play a key role in ensuring that indirect taxes are managed responsibly within their organizations by assigning responsibilities and resources to these functions.

Managing indirect taxes requires clear responsibilities, efficient systems, documented processes and robust controls.

It involves thinking about controversy in every phase of the tax life cycle — tax compliance, tax accounting and tax planning — to identify and rectify issues before they become the subject of a tax dispute.

To better equip your company with proactive planning, we offer insights and in-depth analyses on a number of issues influencing global indirect tax developments.

This article is a summary of our digital report *Managing indirect tax controversy: dealing with audits and disputes*, which can be viewed at ey.com/indirectcontroversy.
In most jurisdictions around the world, insurance premiums are subject to indirect taxation. This could be VAT, GST, stamp duty or other levies, or a specific tax, usually insurance premium tax (IPT).

In this article, we look at some of the recent developments in taxing insurance premiums and the challenges that insurers face in meeting their IPT obligations.

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Insurance premium tax: trends and recent developments

The indirect tax landscape for insurance

In recent years, in line with a global shift from direct to indirect taxation, an increasing number of countries have introduced or increased IPT and similar tax-related charges on insurance.

In the EU, insurance services are generally exempt from VAT (that is, not subject to VAT with no right to input tax deduction). In the past 25 years, following the Second Non-Life Directive issued in 1988, most EU Member States have introduced a tax or levy on insurance premiums.

Outside of Europe, many countries are actually taxing insurance services and premiums with VAT or sales tax. This is the approach that has been proposed for the new GST in India and for VAT in China.

Recent IPT rate and tax changes

A number of countries have introduced IPT in recent years. This trend has been especially strong in Central and Eastern Europe (e.g., Bulgaria, Hungary and Romania). In addition, several countries have increased their IPT rates. The most significant rate change in Europe happened in the Netherlands, where a 9.7% rate was increased to 21% to bring it in line with the Dutch standard VAT rate.

In 2015, a number of European countries also increased the rates for taxes that apply to insurers from other Member States providing insurance cover under “Freedom of Services” (FOS), including:

- France: The IPT rate for legal expenses cover has been increased from 9% to 11.6%.
- Malta: The stamp duty rate applicable to existing taxable non-life insurance policies has been increased from 10% to 11%
- Portugal: The National Medical Emergency Service Fund (INEM) tax rate applicable to accident, health, life, motor and travel insurance policies has increased from 2% to 2.5%.
- Slovenia: The IPT rate applicable to existing taxable insurance policies has been increased from 6.5% to 8.5%.
- Italy: There have been a number of changes to the provincial IPT rates on motor insurance policies for cars registered in each province.
- UK: The standard rate of IPT will increase from 6% to 9.5% from November 2015.
- Greece: The standard rate of IPT levied on most non-life insurance policies has been increased from 10% to 15% with effect from 16 July 2015.

Figure 1. A selection of global IPT changes since the beginning of 2015.

Figure 1. IPT developments in 2015

Recent IPT court cases

Aside from increases in tax rates, various court cases have addressed the scope of insurance and the application of IPT, e.g., about the reinsuranc of suretyship, on the location of risk and related to indemnity agreements. The outcome of the indemnity agreements case, which originated in Germany, has been seen as sensational. The judgment found that insurance does not necessarily have to transfer of risk and the supply can be subsequently subject to IPT – in this case indemnity agreements provided by a head office to its subsidiaries at a percentage of turnover.

In a recent case from the Netherlands, it has been clarified that activities of a company offering breakdown assistance for a fixed annual fee constitute an insurance contract, and they are therefore subject to Dutch IPT.

At the CJ EU level, there have also been a number of decisions on insurance-related cases. In the Mapfre case, the Court’s decision is bringing extended warranty sold by third parties into the scope of insurance. In the case of BGZ Leasing, it has been decided that where a lessor insures an asset and recharges the cost of the insurance, this recharge is a VAT-exempt insurance supply. Lastly, following the RVS case, European IPT is now an issue for many life insurers as the CJ EU clarified that if a policyholder moves to a different country within the European Economic Area (EEA), IPT needs to be paid in the country where the policyholder is habitually resident.

Tax authorities are becoming more proactive

Following the financial crisis, tax authorities have become very proactive in tackling noncompliance by non-domestic insurers. Germany, for example, went from having a loose network of local tax offices dealing with foreign IPT to centralizing the IPT function at the Bundeszentralamt für Steuern (federal tax office). The aim was to ensure that procedures for all foreign/FOS insurers are aligned and also that revenue enforcement targets are set for tax inspectors.

Many tax administrations have increased their IPT teams in recent years and are also working on updating or issuing more detailed IPT guidance. Also, many countries have started working more closely with regulators to identify noncompliant insurers. Information is also coming from the exchange of information between tax administrations — for example, tax inspectors who audit a company and find that a policy was taken out from a non-domestic insurer are now passing on that information to the relevant IPT authorities, who then contact the insurer with an assessment for the unpaid IPT. This is happening to the extent that the basis of premium apportionment across countries where risks are located is also being inspected.

Issues for insurers

The variety of taxes on insurance premiums can be a burden for insurers that issue global insurance policies with risk coverage in many countries, as they need to understand which taxes apply in the countries where the risks are located. Often, insurers also need to administer and pay taxes in those countries and, historically, there has not always been a high level of compliance with “foreign” insurance taxes.

Various trends are forcing insurers to think differently about IPT compliance. IPT, which was previously just seen as a very small revenue source for governments, is becoming more significant as Solvency II and the OECD’s Base Erosion and Profit Shifting (BEPS) initiative drive the importance of correct taxation and compliance issues.

With these considerations in mind, brokers are becoming more concerned about their tax liabilities and their role in calculating taxes for insurers. Even policyholders are less willing to bear the burden of noncompliance and are demanding evidence of correct settlement of taxes by insurers.

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4. Germany: Cologne Finance Court (FG Köln) 2 K 430/11, 6 May 2014.
5. The Netherlands: Dutch Supreme Court (Hoge Raad) 12/05800, 14 February 2014.
6. CJ EU: C-584/13 — Mapfre Asistencia and Mapfre Warranty.
7. CJ EU: C-224/11 — BGZ Leasing sp z o.o v Dyrektor Skarbowej Warszawie.
9. The EEA consists of the 28 EU Member States, Iceland, Liechtenstein and Norway.
Compliance hurdles

There is a lack of uniformity in how taxes apply to insurance. This can be a major obstacle to accurate multi-country compliance and can make it difficult for insurers to adopt standardized processes. For example, the following key elements of tax vary greatly from country to country:

- Risk definition and therefore the tax treatment
- Taxes paid by the insurer as opposed to taxes paid by the policyholder
- Tax settlement for co-insurance arrangements
- Tax points
- IPT credits
- The variety of taxes that apply
- Regional reporting

Many insurers are still unaware of their IPT obligations and risks across the globe. The complex nature of insurance contracts can add to this confusion. For example, most global policies are not provided by just one single insurer; instead, the risk is spread among a number of insurers (this is referred to as co-insurance). Many co-insurers are still relying on the lead insurer to settle the taxes due, without being aware that they may, in fact, be liable to settle their own tax portion as some countries do not allow the lead insurer to settle the tax.

Reliable information about applicable IPT rates and legislation is scarce, and reporting requirements are often unclear. For example, the Hungarian IPT Act, which was introduced in 2013, was just two pages long and left many insurers (and the tax authorities) in the dark over several important questions, such as what is the tax point, how should co-insurance arrangements be treated and who is responsible for bearing the economic burden of the tax (i.e., the insurer or the policyholder).

At the other end of the spectrum, reporting requirements in some countries can be very onerous—for example, the necessity to report IPT regionally in Spain. Another issue facing foreign insurers is the requirement to appoint a local agent. More than 10 years after the abolition of fiscal representation for VAT in the EU, local agents for IPT are still required in some countries, especially in Southern Europe (e.g., in Portugal, Spain and Greece). Even though a recent CJ EU case forced Spain to drop this requirement for IPT, in practice, insurers still need to have a Spanish bank account to make tax payments, and not many FOS insurers have branches in the country. Also, in Italy, where fiscal representation has already been officially abolished, in practice payments can be made only through a local representative.

Data quality is the basis for accurate reporting, but it can be a big issue. Often, systems cannot cope with the reporting requirements as they cannot capture relevant information (e.g., the Spanish postcodes that are required for fire brigade tax reporting in Spain).

Getting IPT compliance right

Getting IPT compliance right usually starts with finding the correct location of the risk. This does not mean simply choosing the obvious country where an insured object or the policyholder is located; insurers and brokers need to consider whether the policy covers multiple insured and mixed risks, which could mean multiple risk locations. Having multiple risk locations can lead to double taxation, especially when a country outside the EEA is involved. Even within the EEA, with common risk location rules laid out in the Second Non-Life Directive, conflicts exist about where and how tax applies.

Some insurers may decide to register everywhere to settle their tax obligations, even if there is a very small tax liability. However, even if they do, there is still plenty to consider for getting their IPT compliance right.

Aiming for 100% compliance is a very challenging goal, and taxpayers need to adopt a consistent common-sense approach to global compliance. The key to improving cross-border IPT compliance is having quality data, appropriate premium allocations and clear audit trails. Achieving this requires commitment not only from the tax department, but also from underwriters and brokers.

A version of this article has previously been published in IBFD’s Derivatives & Financial Instruments

12. CJ EU Case C-678/11 —Commission vs. Spain.
The indirect tax function must consider being more actively involved in managing environmental and energy taxes (EETs), which are continually changing globally.

Global EETs are becoming increasingly relevant to businesses around the world. More businesses are establishing sophisticated energy management and sustainability strategies while EET regimes are undergoing continuous development globally.

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Environmental and energy taxes: as green policies shift, indirect tax has key role

Even though EETs—including taxes on transport and pollution—have a substantial and growing impact on production and energy procurement costs, the administration of these taxes is often left to the facility level, while the role of the indirect tax function in this remains unclear. In our view, indirect tax functions must consider a more active involvement in the compliance and strategic management of EETs.

The impact of these regimes on VAT/GST alone will require the tax function to have a solid knowledge of EET regime principles as well as of the corresponding business processes. However, the tax function can go even further: it can help to identify environmental and energy tax relief opportunities, driving substantial cost reductions, and it can manage the related compliance processes, particularly when there are changes to the business operating model.

Environmental taxes are meant to function not only as a source of revenue but also as an instrument of environmental policy. Together with tradable permits, charges and targeted subsidies, energy taxation is referred to as a market-based instrument (MBI). MBIs aim to incorporate the environmental cost of production or consumption activities (e.g., air pollution) into the cost of production, through taxes or charges on processes or products.

The EU: The main focus of EETs is on the taxation of energy consumption, based on the EU Energy Taxation Directive 2003/96/EC. Further development of these taxes continues to be part of the EU’s 2020 strategy. Consequently, the EU Commission continues to encourage Member States to initiate tax reform programs in this area.

The OECD: On a global level, the OECD has identified and analyzed EET regimes across 52 key economies and identified more than 1,600 scenarios for exemptions and reliefs associated with EETs (see the OECD database here). For the OECD, a particular focus lies in the further development of EET by reducing environmentally harmful subsidies, which are those that increase the amount of waste, pollution and natural exploitation.

Carbon emissions: In addition to well-established regimes such as the EU Emission Trading Scheme (EUETS), the global carbon market continues to grow. As carbon regimes expand geographically and cover more industries, businesses’ tax functions increasingly need to understand carbon markets and their tax consequences.

Encouraging sustainable behavior: Governments around the world are also encouraging sustainability and sustainability-related investments through tax incentives, covering measures to reduce emissions, produce renewable energy, increase energy efficiency, or develop low-carbon products and manufacturing techniques.

EET opportunities and challenges

VAT/GST challenges: A number of VAT/GST consequences result directly from the developments in EETs and the related external and internal factors. First, new business activities and transactions must be identified and evaluated for VAT purposes (e.g., the effect of participation in environmental market-based instruments in the form of trading regimes for emission or other environmental permits).

Furthermore, energy taxation regularly arises in connection with a taxable supply of energy products such as electricity. This creates challenges for identifying the proper tax base of the transaction, in particular if energy taxes are subsequently reclaimed/refunded to the recipient. In particular, complying with the proper VAT invoicing process is important both for the supplier and the recipient of the supply.

Energy tax reliefs and further tax implications

Tax management: the management of EETs creates a considerable challenge in the form of both risks and opportunities. This is particularly the case for EU energy taxes. A business indirect tax function may be best suited to address these issues. Both from the point of view of systematic controls as well as from the perspective of dealing with the underlying transactions, the EET issues that businesses face are often closely connected to similar VAT/GST challenges.

Exemptions and reliefs: Even though the specific energy taxation rules vary among Member States, common tax exemptions and reliefs are granted in many countries. They include the preferred use of fuels and electricity by production businesses and the use of energy products in specific production processes. Furthermore, tax exemptions or reliefs may be granted for consumption by specific energy-efficient installations or sustainable consumers.
Using reliefs: The challenges for businesses with regard to utilizing the applicable reliefs include:

• Properly identifying the preferred consumption amounts subject to the relief can present a substantial practical challenge, as these types of reliefs are often linked to specific industrial processes that, in turn, are integrated into the overall activity at the business location. Thus, the consumption amounts are not metered and invoiced separately.

• Energy tax reclaims are granted either by way of a reduced energy tax rate on the invoice of the supplier or by filing a separate claim with the authorities for a refund of the energy tax paid to the supplier. Businesses often do not recognize this activity as a tax filing obligation, and thus these claims are not considered in the wider tax compliance management process. Instead, reclaim processes are managed at a facility level by the local finance function or by another business stakeholder without sufficient input or supervision by the tax function. However, this is often not appropriate—especially as the utilization of these reclaims generally results in similar legal obligations to those for filing a VAT/GST return.

Multidisciplinary management approach (MDMA)

The management of all of these energy tax impacts is challenging for an indirect tax function, particularly in a multinational company. This difficulty is not only due to the very specific tax regulation related to EETs but also to the related technical and environmental aspects.

To effectively manage EET, a joint multidisciplinary management approach (MDMA) involving all the related business functions is advisable. Using an MDMA not only helps the tax function understand relevant technical and regulatory backgrounds, it can also help other functions understand energy tax impacts and help them to optimize the energy tax position of the business.
Outlook

The further development of EET legislation will be substantially impacted by the wider regulatory framework. For the EU, this concerns state aid regulations in particular. Tax exemptions and tax reliefs are considered to be formal state aid subject to restrictive regulations. Various national exemption rules have already had to be modified or abolished due to these provisions, and more developments may be expected in this area.

Furthermore, most EET regimes are still relatively new, and the interpretation of national rules and case law is still developing. The resulting developments will require effective monitoring and management going forward.

Thus, tax functions will be increasingly challenged to support EET both on an operational and on a strategic level. Operationally, the tax burden may be minimized by utilizing available tax exemptions and reliefs; however, at the same time it is vital to ensure full tax compliance. Strategically, businesses will need to be aware of upcoming changes to effectively predict and manage their tax costs related to energy use and environmental issues.
We continue our series looking at the indirect tax features of trade blocs in Africa. In our previous article, we dealt with the East African Community (EAC). In this article, we look at trade blocs in southern Africa, specifically the Southern African Customs Union (SACU) and Southern African Development Community (SADC).

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1. Indirect Tax Briefing, Issue 11, ey.com/indirecttaxbriefing.
3. Botswana, Lesotho, Namibia, Swaziland and South Africa.
What are trade blocs?
Trade blocs are region-based agreements, the main aim of which is to reduce or eliminate barriers to international trade in goods and services. To this end, these agreements typically include provisions to:

- Eliminate tariff and non-tariff barriers
- Harmonize customs legislation and technical regulations
- Address freedom of transit (nondiscriminatory treatment of vehicles in transit and goods transported by them)

Trade blocs typically go through the following maturity levels from inception to full maturity:

- Preferential Trade Area: Countries within a geographical region agree to reduce or eliminate tariff barriers on selected goods imported from member countries.
- Free Trade Area: Countries agree to reduce or eliminate barriers to trade on all goods coming from other members.
- Customs Union: Countries agree to remove tariff barriers between members, as well as implement a common external tariff against non-members on imported goods (including harmonized customs legislation and regulations, as well as freedom of transit).
- Common Market Area: This represents the first significant step toward full economic integration and occurs when member countries trade freely in all economic resources. This means that all barriers to trade in goods, services, capital and labor are removed.

African trade blocs
Regional integration has been at the forefront of the African development agenda since the attainment of independence. This integration is seen as a way to solve the continent’s slow economic growth and high unemployment. The need to integrate has fueled the formation of 14 regional integration groupings (trade blocs) across the continent, with most countries belonging to two or more regional organizations, resulting in multiple and overlapping memberships. This often causes confusion and tends to hinder economic growth.

SACU Agreement
SACU is the world’s oldest customs union, founded in 1910. Its objectives include:

- Facilitating cross-border movement of goods between member states
- Substantially increasing investment opportunities
- Facilitating the development of common policies and strategies
- Facilitating the equitable sharing of the revenue arising from duties levied by member states
- Promoting integration into the world economy

All goods imported into SACU are subject to a common external tariff (i.e., subject to the same customs duties on importation). The movement of goods intra-SACU is not subject to the payment of customs duties (only VAT is levied). To facilitate trade and reduce the cost of customs compliance, the customs authorities of SACU member states have either recently modernized their customs processes (e.g., the South African Revenue Service has replaced legacy systems with a fully automated and centralized processing system for all commercial trade across our borders) or are in the process of doing so (e.g., implementation of the Automated System for Customs Data (ASYCUDA) program). The customs legislation and technical regulations governing SACU trade are largely aligned.

Originally, the customs duties collected from SACU imports were shared in proportion to each country’s trade. This formula has since been amended, with the latest formula resulting in an increase in the share accruing to the BLNS (Botswana, Lesotho, Namibia and Swaziland) countries.

However, the future of SACU is in the balance. This uncertainty is due to the lack of agreement between member countries on an equitable revenue-sharing formula. Over the years, some members of SACU have become increasingly dependent on the revenue received from the pool. The current formula is said to be hampering trade negotiations and industrial policy development in the BLNS countries. The South African Finance Minister, Nhlanhla Nene, has commented that South Africa is subsidizing the other SACU members to compete with them for investment, given their more attractive taxes.

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SADC Agreement

The SADC Agreement came into force in 1980. The Trade Protocol signed in 1996 aims to eliminate import tariffs in phases with effect from the year 2000; 12 of the 15 members have ratified the Trade Protocol (Angola, Seychelles and the Democratic Republic of the Congo remain outside the agreement).

The objectives of the Trade Protocol are to:

• Further liberalize intraregional trade in goods and services
• Ensure efficient production of goods within SADC
• Improve the climate for domestic, cross-border and foreign investment
• Enhance economic development, diversification and industrialization in the region

Originally, the aim of the Trade Protocol was for import duties on 85% of products traded intra-SADC to be phased down over an eight-year period (with 15% made up of sensitive products to be liberalized by 2012). The protocol further anticipated the establishment of a Customs Union in 2012 and a Common Market in 2015.

Most of the above ideals have been met, albeit within a slightly extended period. The Free Trade Area is largely complete in terms of customs tariffs. For instance, countries such as the Seychelles, Angola and the Democratic Republic of the Congo remain outside the agreement. Although there are indications that Angola will join in 2017, this can happen only when Angola has finished its membership road map, which is currently being drawn up. Malawi, Zimbabwe and Tanzania all have derogations that include imposing 25% import duty for the sugar and paper industries until 2015. The trade bloc has not yet reached Customs Union or Common Market status, and it will be years before these goals are achieved.
Conclusions

It is evident that both southern African trade blocs have made progress over the years, but they have also experienced their fair share of challenges that may threaten their very existence. The SACU trade bloc seems to be at the point of dissolution due to the members’ inability to resolve the challenges related to the revenue-sharing formula. Some of the SADC members remain outside the operations of the Trade Protocol 19 years after it was signed. The confusion associated with multiple memberships of different blocs has often resulted in calls for the SACU to be abolished, given that all its members are also members of the SADC.

On a positive side, members of the EAC and COMESA and SADC signed the first phase of a Tripartite Free Trade Agreement on 11 June 2015 aimed at:
- Easing trade restrictions
- Allowing for easier movement of goods and persons
- Resolving challenges posed by multiple memberships
- Paving the way for the Continental Free Trade Area to be launched during the course of 2015

These developments are welcome in that they ultimately reduce costs of doing business in Africa. However, the exchange of offers on trade is not complete. The agreement does not address rules of origin, trade remedies and dispute resolution. This agreement will enter into force only once all the members have ratified it.
A new mountain to climb

Tax reputation risk, growing transparency demands and the importance of data readiness

Companies face more reputation-related tax risks than ever, according to our report, A new mountain to climb. Public opinion is driving political action and requiring a higher threshold than complying with the letter of the law.

Constant scrutiny from stakeholders, especially news and social media, has businesses concerned about protecting their brand. If a company doesn’t proactively manage the increased reputational risk posed by the ongoing “fair share of tax” debate, its image can be quickly tarnished.

In our survey of 962 tax and finance executives in 27 countries, we found:

- 89% of those who worked for the largest global companies said they were somewhat or significantly concerned about news media coverage, how much companies pay in tax or their seemingly low effective tax rates. In 2011, fewer than half of companies said they were similarly concerned.

- 94% of the largest companies having an opinion on the matter think that global disclosure and transparency requirements will continue to grow in the next two years.

- 83% said they regularly brief the CEO or CFO on tax risks or tax controversy.

- 43% said they regularly brief the audit committee.
Greater transparency on the horizon

As stakeholders become more concerned about where tax revenue is coming from, more tax transparency obligations are being put in place.

At the same time, governments have opened their lines of communication and are now exchanging more information related to individual and corporate taxation.

From forthcoming country-by-country reporting rules proposed by the OECD under Action 13 of its Base Erosion and Profit Shifting project to a new package of tax transparency proposals from the European Commission, what a business tells one government about its taxes, it will soon be telling all.

Preparation, communication and flexibility are instrumental for businesses facing this new transparency environment.

Companies need:

• Robust processes and oversight
• Watertight documentation and audit trails
• Leading operational systems
• World-class data management systems

With these elements in place, new reporting obligations can be met with less disruption to business activities. Furthermore, the appropriate communication tools can be developed to help mitigate future reputational risks. Such readiness will also help companies to communicate more effectively internally as well as externally.

Six tactics to help you prepare

1. Actively monitor the changing landscape. Track media coverage and social media channels. This may require closer collaboration with communications and PR functions within the enterprise.

2. Assess your readiness to respond to reputational risk threats. Understand whether you have complete visibility of tax structures and taxes paid wherever you operate. Know whether taxes paid are in line with your business results. And know whether the board has an agreed-upon strategy and plan of action for responding to a negative story.

3. Enhance communication with internal and external stakeholders. Communicating effectively about your company’s total tax picture, tax policies and overall tax profile is critical to successfully managing tax reputation risks. Be sure your company is prepared if a crisis were to come about.

4. If appropriate, prepare a total tax picture. The development and sustenance of an accurate total tax picture often sits at the heart of a tax reputation risk strategy. It incorporates much more than listing of taxes paid around the world, instead presenting deeper insights on why a company operates where it does, why it is structured in the way it is and how it manages its tax department.

5. Decide with whom your company wishes to communicate about tax. Beyond governments, investors may want to know how the OECD and other reforms will affect your company. You may wish to assure employees your tax policies are sound. You may also decide to adopt a media strategy.

6. Embed reputation risk thinking into your business and decision-making processes. In the current environment, tax issues can emerge from almost anywhere. Be sure to factor reputation risk into your business operations and focus on case-scenario strategies.

Don’t leave your company’s reputation to chance. To thrive in the current reputation risk environment, it can be useful to define yourself before others define you.

Access the full report at ey.com/taxriskseries
In December 2014, the European Commission issued consolidated preliminary drafts of the delegated and implementing acts under the Union Customs Code (UCC). Although adopted in 2013, most provisions of the UCC will apply starting 1 May 2016. In the meantime, the Commission continues the work on the delegated and implementing acts to ensure EU Member States implement them before the UCC’s effective date.
The latest consolidated preliminary drafts of the delegated and implementing acts reflect the “state of play of discussions with Member States and other stakeholders” and served as the basis for discussions in January 2015. The Commission is expected to adopt the delegated and implementing acts — subject to minor changes — and to publish them in May 2015.

In this article, we focus on customs valuation items, more specifically, the possible changes to the existing “first sale for export” rule and the inclusion of royalty and license fees in the transaction value. In doing so, we will provide an update of the results of the latest discussions.

The consolidated preliminary draft Implementing acts include a provision that explicitly refers to the transaction, on the basis of which customs value is determined:

“The transaction value of the goods shall be determined at the time of acceptance of the customs declaration on the basis of the sale occurring immediately before the goods are brought into the customs territory of the Union.”

This above provision has not been substantially amended since the second preliminary drafts were issued: the European Commission has not changed its viewpoint and finds that the transaction value should be determined on the basis of the last sale rather than an earlier sale. Moreover, it is apparent that the discussions with Member States and stakeholders in mid-January did not persuade the European Commission into making any concessions. If adopted, the above provision would in effect abolish the existing “first sale for export” rules, which allow EU importers that meet certain requirements to declare the price paid in the earlier sale (i.e., the first sale) for customs purposes, resulting in a lower dutiable value and, thus, lower customs duty obligation.

The wording of subsequent preliminary drafts is a source of concern to business stakeholders who have expressed their views on numerous occasions.

Noteworthy of this concern is that the rule, as amended, seems to exclude sales made within the EU. While the second draft refers to: “the transaction occurring immediately before the goods are declared for free circulation,” the subsequent consolidated draft refers to: “the sale occurring immediately before the goods are brought into the customs territory of the Union.” In addition, a second paragraph has been added as follows:

“Where goods have not been sold for export to the customs territory of the Union before having been brought into that customs territory, the transaction value shall be determined on the basis of their sale at the moment the goods are in temporary storage or placed under a special procedure other than internal transit, end-use or outward processing.”
The above statement is inconsistent with the WTO’s Customs Valuation Agreement, which defines the transaction value as “the price actually paid or payable for the goods when sold for export.” According to the Commission’s current draft, a transaction within the EU could also be the basis for the “transaction value.” In contrast, where goods have not been sold for export, the WTO Customs Valuation Agreement requires use of one of the alternative methods of valuation.

Transitional period for first sale
As it is highly unlikely for the Commission to change its approach to valuation under the Union Customs Code, one concession currently under consideration, prompted by a proposal made by one of the member states, is to allow first sale valuation for a transitional period until 31 December 2017 for situations where a contract was in place before the new regulations were adopted.

Royalties and license fees: an attempt to increase the taxable scope
The implementing acts will include one consolidated article on the definition of royalties and license fees, which elaborate on the applicable test criteria, i.e., that the payments are “related to the goods being valued” and that these are “a condition of sale.”

The text of the consolidated preliminary draft remains unchanged from that of the second draft regarding royalties and license fees, apart from the addition of the following paragraph:

“If royalties or license fees relate partly to the imported goods and partly to other ingredients or component parts added to the goods after their importation, or to post-importation activities or services, an appropriate apportionment may be made only on the basis of objective and quantifiable data.”

The above corresponds mutatis mutandis to the paragraph 3 of the current Article 158 of the Community Customs Code Implementing Provisions.

This being said, we focus on the “condition of sale” rules. These rules have been the subject of heated debate between business stakeholders and the European Commission. Given the current information, the implementing acts will provide three situations where the “condition of sale” is assumed when any of these is met:

• The seller or person related to the seller requires the buyer to make this payment
• The payment by the buyer is made to satisfy an obligation of the seller, in accordance with contractual obligations
• The goods cannot be sold to, or purchased by the buyer without payment of the royalties or license fees to a licensor
The third item seems to include a variety of situations and leaves ample room for interpretation. For instance, in a scenario whereby the buyer, the seller and the licensor are all unrelated, a royalty or a license fee could still become dutiable. Moreover, the rule seems to shift power to the licensor since it focuses on the obligations of the buyer, rather than the requirements of the seller. Put differently, a licensor can generally block the sale if the royalty is not paid by the buyer.

Consequently, the royalty would become dutiable in almost all situations. Furthermore, the rule does not mention that for a royalty or a license fee to become dutiable, it should be the buyer making this payment. This is inconsistent with the WTO’s Customs Valuation Agreement and the UCC, both of which refer to the buyer making a payment either directly or indirectly.

The above rule appears to be an attempt to increase the taxable scope, making royalties and license fees much more easily included in the customs value.

**Conclusions**

Market operators are anxiously awaiting the final disposition of the above items as it can have a major impact on imports into the EU. In view that favorable changes are unlikely, companies should already consider taking preliminary steps to optimize future situations, e.g., by carefully reviewing existing structures and intellectual property contracts to exclude a “condition of sale.”
The tour operators’ margin scheme (TOMS) is a well-known (and less than popular!) compulsory margin accounting scheme for EU businesses that buy in and recharge the cost of travel services. The scheme is primarily a concern for those in the travel and tourism sectors.

What isn’t as well-known, and apt to cause the occasional trap (and unexpected VAT cost), is that TOMS may apply to businesses operating in other sectors that buy in and recharge travel costs. This article looks at how TOMS can apply in unexpected circumstances and explains why all businesses need to be aware of it. It does not focus on the mechanics of TOMS but, with the help of a case study, explores how a UK business can be caught off guard by TOMS and how hidden VAT costs can arise. We also present some potential options for mitigating the cost.

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The TOMS VAT rules

TOMS departs from the normal VAT rules in a number of respects. A TOMS supplier:

- Makes a single supply even if providing a package. A business offers a package consisting of a flight to Switzerland, accommodation at a resort hotel and a skiing event. Normally the business would need to establish whether it is making separate supplies of the above items (at different VAT liabilities) or a single supply of all of them (at a single liability). Under TOMS, these considerations don’t arise, because a TOMS supplier always makes a single supply, this being the service of putting together the package.

- Supplies the service from its place of establishment. If the business is based in the UK, the place of supply will be the UK, even though the package destination in this example is Switzerland and the customers could be from anywhere.

- Charges VAT only if the TOMS package is used within the EU. The supply is standard-rated if the package destination is in the EU and zero-rated otherwise. The UK business in this example will apply zero-rating to its Swiss package. If the skiers cross the Matterhorn overnight and spend their second day in Italy, however, the company must account for standard-rated VAT on the Italian element of the package, making a fair and reasonable apportionment of the costs.

- Does not recover input VAT. The business cannot recover any input VAT on costs that directly relate to the package (e.g., hotel, restaurant, ski instructors) because the business does not charge VAT on its own supply.

- Charges VAT on the margin. The TOMS calculation is complicated but, broadly, the TOMS margin is the difference between the selling price and the VAT-inclusive costs of putting together the package. TOMS VAT is treated as included in the margin, so a UK supplier applies VAT at 20% to the margin to work out its TOMS output tax liability.

Case study: Brainstorm & Company

Brainstorm & Company is an international consulting firm specializing in “blue-sky” thinking. The firm is holding a client conference entitled That Thinking Feeling to be hosted at Headspace, Brainstorm’s head office in the UK.

Brainstorm’s most important UK client, Deliverable plc, sends a number of employees to attend the conference. Brainstorm makes a block booking at a local hotel to provide client delegates with accommodations during the conference. The hotel invoices Brainstorm for the booking, charging VAT at 20%. Following the conference, Brainstorm recharges the hotel expense (plus VAT at 20%) to its clients as part of the overall charge for the conference and recovers the VAT charged by the hotel on its UK VAT return.

Is Brainstorm correct in doing this? Unfortunately not! Brainstorm has unwittingly fulfilled all the requirements of a TOMS supplier:

- It has bought in and resold TOMS services — in this case, hotel accommodations. (TOMS also applies to a range of other services, including passenger transport and trips/excursions.)

- It has done so at a markup, in its own name and without material alteration.

- It has sold to the end user of the services. (For corporate customers like Deliverable, this refers to use by its employees and directors.)

Instead of recovering the hotel VAT and charging output VAT to its client, Brainstorm should be accounting for TOMS VAT on its markup. The impact of TOMS on Brainstorm and Deliverable can be illustrated by comparing Scenarios 1 and 2 below. Scenario 1 set out the situation had TOMS not existed, while Scenario 2 sets out the actual TOMS scenario facing Brainstorm. For the purposes of this example, we use a hotel room costing £100, on which VAT is charged at 20% (£20), and a markup of 5% for Brainstorm.

Scenario 1. If TOMS did not apply

<table>
<thead>
<tr>
<th>Hotel</th>
<th>Brainstorm</th>
<th>Deliverable</th>
</tr>
</thead>
<tbody>
<tr>
<td>£100 + £20 VAT</td>
<td>£105 + £21 VAT</td>
<td>Net VAT cost in chain: £1</td>
</tr>
</tbody>
</table>

Recoverable by Brainstorm Recoverable by Deliverable

Brainstorm incurs and recovers VAT of £20 and accounts for VAT of £21. Deliverable is charged VAT of £21 by Brainstorm and recovers VAT of £21 as a normal business expense (assume Deliverable is fully taxable).
In Scenario 2, we have assumed that Brainstorm is able to pass on the entire VAT cost to Deliverable. Note that Brainstorm, by consequence, accounts for VAT on the same base (£126 – £100 – £20 = £21) and therefore at the same amount (£1) in each scenario. This would be the expected position if Brainstorm were a tour operator selling holiday packages to the general public.

In reality, Brainstorm's customer is a business entity and would normally expect to recover the VAT on an expense incurred in the course of its business. Brainstorm could try to pass on the cost to Deliverable, or at least to suggest a split, but it may not wish to upset an important client. Whatever happens, an unexpected 20% VAT cost is likely to be commercially disruptive for Brainstorm.

**Disclosed agency**

If Brainstorm is acting as the hotel's agent, Deliverable will have to agree to a contract with the hotel for the supply of accommodations. Depending on Brainstorm’s bargaining power, this may mean that Brainstorm is no longer free to set its own commission. In the event of complaints about the accommodations, Deliverable will have recourse to the hotel rather than to Brainstorm. This may not be to Deliverable’s liking (especially as it is Brainstorm’s conference).

As a large corporation, Deliverable is likely to have its own travel procurement policies and may prefer to rely on them if it has to make its own arrangements.

If Brainstorm takes this route, it should ensure that its conduct and practices are consistent with disclosed agency status. The case of *HMRC vs. SecretHotels2 Ltd.* (2014) UKSC 16 demonstrates that inconsistencies between contractual terms and aspects of an “agent’s” conduct are likely to lead to challenges. Although the Supreme Court ultimately decided in favor of agency status, the issue was questioned at every level of the UK tax appeals process. Particularly significant in that case were the “agent’s” freedom to charge its own commission (which it did not disclose to the hotels), its handling of customer monies, and its direct dealings with the customers in the matter of complaints and compensation.

Alternatively, if acting as Deliverable’s agent, Brainstorm will have to agree to a contract with the Deliverable for its agency services, while Deliverable again must contract directly with the hotel for the supply of accommodations.

**Commission**

As the hotel’s agent, Brainstorm must charge the hotel a separate agency fee and must not charge any markup to Deliverable. Brainstorm should not handle the monies paid by Deliverable in respect of the hotel room, which Deliverable should remit directly to the hotel.

As Deliverable’s agent, Brainstorm’s commission will be known to Deliverable. This may be commercially sensitive.

In both cases, Brainstorm’s agency fee will be subject to UK VAT at 20% (following the VAT treatment of the underlying supply of hotel accommodation—that is, taxable where the hotel is located).
**Invoicing**

As the hotel’s agent, Brainstorm must issue the hotel with a valid VAT invoice for its agency services (self-billing may be an option), while the hotel will issue its VAT invoice for the accommodation to Deliverable. Deliverable will use this as the evidence to support its claim for input tax recovery.

As Deliverable’s agent, Brainstorm must observe the invoicing protocol known as “hotel billback.” Broadly, the hotel must address its invoice to Deliverable c/o Brainstorm, while Brainstorm must issue a payment request to Deliverable, which Deliverable will use as the basis for its input tax recovery claim. Brainstorm will also issue a valid VAT invoice to Deliverable in respect of its own agency services, which Deliverable will use to recover input tax on Brainstorm’s supply of agency services.

**Conclusion — disclosed agency**

Disclosed agency does provide a solution to the sticking VAT problem posed by TOMS, and the UK tax authorities (HMRC) confirm that it is entirely open to businesses to act in this way. However, this billing method comes with its own commercial disadvantages that may outweigh the VAT benefit. Brainstorm will need to consider whether its relationship with Deliverable and the contractual position (including, for instance, in the terms and conditions) make disclosed agency a viable option.

**Wholesale supplies**

Things are different when business customers purchase travel services for resale to their own customers or other third parties (called wholesaling).

Let’s take our example further. Brainstorm is considering a merger with a German consulting firm, Drang KG. The firms embark on a feverish round of negotiations. Drang’s senior partners travel to London for a series of meetings at Headspace.

As a goodwill gesture, Brainstorm books suites at a hotel for the Drang partners. Negotiations sour somewhat, and Brainstorm decides to recharge the costs of the suites to Drang, adding a markup for its time and expense in arranging the booking. So far, this falls into TOMS. However, two of the suites are used by Drang’s lawyers, Klug & Kopf GbR. Drang recharges the costs it incurs from Brainstorm to Klug & Kopf.

Under UK domestic law, “wholesale” supplies have been mandatorily excluded from TOMS since 1 January 2010 (when an “opt-in” for wholesale TOMS supplies was abolished). However, things have been shaken up again by a set of infraction proceedings against those Member States taking the opposite position to the UK (i.e., treating “wholesale” supplies as falling within TOMS). In September 2013, the CJEU confirmed that wholesale supplies indeed do fall within TOMS.
As EU law takes precedence over incompatible national provisions, taxpayers in noncompliant Member States are automatically entitled to rely on the CJEU’s decision in applying TOMS to their “wholesale” supplies as well as their supplies to end users. HMRC acknowledged this following the CJEU’s decision. However, recognizing that enforcing TOMS on all “wholesale” supplies would be seriously disruptive to the travel sector (and that the European Commission is currently considering a reform of the TOMS system), HMRC has advised that “wholesalers” may continue to treat “wholesale” supplies as outside the scope of TOMS until further notice.

If Brainstorm opts to apply the “wholesale” treatment, its supply to Drang will be one of hotel accommodations (a land-related supply of services subject to VAT in the UK, where the hotel is located). Brainstorm will charge VAT at 20% on its markup as for a normal domestic UK supply and will be able to recover the VAT charged by the hotel, subject to meeting the usual requirements for VAT recovery. The net impact will be as in Scenario 1 above.

Drang, however, finds itself in the TOMS situation: it is reselling travel services to a business customer for its own use. As such, it needs to account for UK TOMS VAT on its markup and is unable to recover the VAT charged by Brainstorm. Drang will be faced with a UK VAT registration.

For Brainstorm, the “wholesaling” option offers a potential escape route from TOMS. However, Brainstorm needs to consider whether enforcing a UK VAT registration on Drang will help negotiations, while Drang and Klug & Kopf have to grapple with the question of who bears the hidden TOMS VAT cost.

Again, the parties should consider whether disclosed agency is a viable option. In this instance, Brainstorm has two parties to deal with, which would exacerbate the administrative burden and perhaps the commercial sensitivities of entering a disclosed agency arrangement.

It is worth noting that Brainstorm already has a UK VAT registration, and so the UK VAT implications of “wholesaling” are administratively unproblematic. Had the hotel been located elsewhere, Brainstorm would have needed to consider the local VAT implications in that country. In many EU Member States, a local VAT registration would be a likely outcome, which may complicate using the “wholesaling” route. Moreover, Brainstorm would need to tread carefully in dealing with those Member States where “wholesale” supplies are treated as within TOMS, as the local tax authorities will expect TOMS VAT to be accounted for in the UK. These issues are beyond the scope of the current article, but TOMS will remain difficult territory for travel “wholesalers” until the European Commission completes its review.

**Conclusions**

The story of Brainstorm illustrates how TOMS introduces a hidden VAT cost into the supply chain. Disclosed agency offers a possible escape route but may be commercially unviable. Where “wholesaling” is an option, the wholesaler may be relieved of a TOMS liability, but the hidden VAT cost is pushed further up the chain, where it can still have a commercial impact.

So is there a happy ending for Brainstorm? Going ahead with the merger would be helpful - at least for TOMS purposes – as internal recharges within the same legal entity are outside the scope of VAT. In the meantime, businesses buying in and recharging travel costs to different legal entities - be they customers, suppliers or fellow group entities - need to look out for TOMS!

A version of this article first appeared in the 30 October 2014 edition of Taxation magazine.
India update: introduction of goods and services tax

India’s Parliament is considering a bill to establish a goods and services tax (GST). This new indirect tax regime will raise significant issues for both the Indian tax administration and taxpayers.

On 20 May 2015, EY hosted a discussion of the India GST bill as it journeys through the Indian legislature. We provided an update of the bill’s status and analyzed how enactment delays could affect its proposed April 2016 effective date. We also discussed how your business can prepare for the new tax regime and review lessons learned from helping businesses prepare for indirect tax transformations in other countries.

Replay the webcast at:

Goods and services tax is on its way – are you ready?

The government of India first proposed that a number of indirect taxes levied on goods and services by the center and states be replaced by the goods and services tax (GST) a number of years ago. After several years of uncertainty, the GST project now seems truly underway, with a planned introduction date in April 2016. Now is the time for all businesses that operate in India to consider the impact of GST and start to prepare for the rollout.

The scope of GST is anticipated to be comprehensive, covering virtually all goods and services supplied in India, with minimal exemptions. Therefore, GST will have a far-reaching impact on virtually all aspects of operations and infrastructure, including contractual arrangements; pricing; supply chain design; staff training; and IT, accounting and tax compliance systems.

In this article, we provide an update on the legislative process for the introduction of GST and outline some of the ways that businesses can prepare.
Update on the legislative process

One of the key steps for the introduction of GST in India is the passage of the proposed Constitution Amendment Bill (the Bill), which requires a two-thirds majority in both houses of the Central Parliament and more than 50% majority in the state legislatures. The Bill will empower both the center and state governments to concurrently levy a dual GST on supplies.

Reference to the Select Committee

The Bill, which was tabled in the Lower House of the Central Parliament on 19 December 2014, was passed by the Lower House on 6 May 2015, signaling an important milestone in the journey. The real challenge to the early passage of the Bill was in the Upper House, where the current government lacked the required two-thirds majority, and the expectation was that the main opposition parties would delay the passage of the Bill. What played out in the Upper House was what was expected, the Bill that was tabled on 12 May 2015 was referred to a Parliamentary Select Committee on the insistence of the opposition for a quick scrutiny of the Bill.

The reference to the Select Committee is timebound, and they are expected to return the Bill after discussion by the last day of the first week of the monsoon session of the Parliament. The Bill is expected to be passed in the monsoon session of the Parliament.

Although the Bill is expected to pass, the reference to the Select Committee does constitute a delay in the rollout process, which makes the planned implementation date of April 2016 very ambitious and challenging. However, the review provides an opportunity for the Select Committee and stakeholders to consult on some of these issues. A better designed GST system may emerge after the Select Committee stage, which is to be welcomed.

Origin-based tax for inter-state supplies

First and foremost, among the potential design flaws of the new GST is the proposed levy of an additional 1% origin-based tax. This tax, which is to be collected by the center and then handed down to the states, will apply to the supply of inter-state goods. The 1% tax is outside and additional to the dual GST levy, and it is not creditable as input tax in the GST chain. The addition of a non-creditable origin tax on the supply of goods in a destination-based GST is a serious distortion, and it could lead to significant tax cascading as, according to the current design, it will apply even on intracompany stock transfers and self-supplies. This tax would actually be more damaging than the current concessional 2% origin tax and will lead to significant distortions of the supply chain. Also, to a large extent, it will prevent the new GST from achieving the long-held request by Indian industry for an indirect regime that allows the creation of a common market where supply chain design is driven more by business needs rather than by the need to reduce tax cascading. Another vexing issue could be the valuation of self-supplies subject to the tax, which could result in avoidable disputes.

The strong industry response to this distortive measure has prompted the Union Finance Minister to make a statement in Parliament that the legislators will ensure that the origin tax is not cascading. However, for this tax to eliminate cascading would mean repealing this proposal, which may have its own political consequences because this measure was driven by manufacturing states that were concerned about losing their current origin-based tax revenues. However, this argument is flimsy. The Center to allay fears of any revenue loss due to GST implementation, has committed to compensate the states for 100% of the lost tax for the first three years, 75% for the fourth year and 50% for the fifth year following introduction. It is hoped that the Select Committee will recommend a complete repeal of this proposal and that the Government will amend the Bill accordingly. Another possible compromise would be to restrict such a levy only to inter-state sale transactions of goods to reduce the cascading.

The scope of GST

The Select Committee may also debate the scope of the new tax, in particular the inclusion in the tax base of sectors that are currently excluded from design (such as real property and alcohol for human consumption).

Petroleum is included in the GST base, but products such as petrol, diesel and aircraft turbine fuel are expected to be excluded from GST to start with. These petroleum products are inputs for several industries and also major outputs for refineries. Keeping them outside GST could lead to tax cascading unless these products are zero-rated (i.e., taxed at 0% with a right to recover input tax) and not exempted.

The scope of GST and the breadth of the tax base are important, as they will determine the standard rate structure, currently contemplated in the range of 18% to 22%. A wider tax base could reduce the standard rate. In addition, certain special taxes, which are currently not subsumed into the GST, need to be considered in the overall tax burden.
Preparing proactively for GST

While we await the outcome of the Select Committee’s deliberations and the final passage of the Bill by the Parliament (expected to be in August 2015), these legislative delays will no doubt make the planned implementation date of April 2016 challenging. The timetable may be modified to reflect these actions. But, in our view, the delay (if any) will be not be substantial, and GST implementation looks certain for 2016. Therefore, there is no excuse for inaction now. On the contrary, businesses should take full advantage of this period to be better prepared for the rollout of GST when it happens.

Lessons learned from Malaysia GST

Malaysia introduced a new GST on 1 April 2015. EY has been advising businesses and government departments on the implementation, and we have identified a number of lessons from the process that could benefit businesses operating in other countries where a new consumption tax is introduced.

We think these lessons are particularly relevant in India. One lesson from the Malaysian experience is that complete awareness and proactive preparation will be of paramount importance in handling this huge tax reform effectively.

Malaysian GST is a fairly simple tax, with a single rate, and taxpayers had a great deal of advance notice of the law and rules. However, the reality for many businesses was that the rollout was far from seamless because of a lack of awareness and preparedness; the new tax led to business disruption, operational issues and delayed compliance for many. We believe that one reason for this lack of preparation was that the GST had long been discussed and repeatedly delayed. A typical response from many businesses was “it won’t happen, so we will worry later,” but this attitude meant that affected taxpayers deferred taking the necessary actions until it was too late and then they faced huge challenges and disruptions in implementation.

In fact, the need for preparation may be even greater in India than in Malaysia. The Indian GST will be unique and far more complex than the Malaysian tax, with a dual GST regime and levy of GST on inter-state supplies of goods and services, including intracompany stock transfers. Besides, the proposed design has additional 1% origin tax on inter-state supplies of goods outside the GST chain, which will be non-creditable. In addition, by the time we have a clear idea of the GST law and rules, businesses will be left with just 60 to 90 days for implementation if the planned date remains as April. If businesses wait to act until then, our experience suggests that preparing in time will be very difficult indeed.

Business transformation

Although the introduction of GST is a tax reform, it should be approached as a complete business transformation because it will have an impact on every aspect of the business. Suggested actions across the business are outlined in Figure 1.

The key areas of business for GST introduction include:

- **Advocacy** — tax policy discussions by industry sectors and individual taxpayers around issues such as the tax rate, the place-of-supply rules, the treatment of existing incentives and valuation
- **Indirect tax impact assessment** — the strategic and operational impact of GST on revenue and procurement streams, costing and pricing of products and services, working capital and cash flows, and transitional provisions for carryforward of existing credits
- **Supply chain** — operating model and network redesign across sourcing and distribution, contracting and process changes
- **Accounting and reporting** — tax credits, payments, changes in accounting entries (including revised charter of accounts in compliance with Indian Accounting Standards), and a risks and control framework
- **Technology refresh** — ERP and other system changes, GST reporting changes, system ready for audit and potential automation of GST compliance
- **Compliance** — GST registrations, tax credit transitions, return reporting formats and statutory compliances, explore shared service and managed outsourced services for GST compliance
- **Program management** — GST program planning across diverse stakeholders, program integration, budget management, quality assurance and timely communications
- **Change management and training** — enabling business engagement, training staff and educating suppliers and customers, and facilitating business readiness

Figure 1. India GST – is your business ready for transformation?
All of the actions outlined in the list are integral to how GST will have an impact on your business and how smoothly the transition takes place.

**Conclusions**

Businesses that are proactive in preparing for the GST early can gain a real competitive advantage by reducing disruption and maintaining and improving relationships with suppliers and customers alike. Each action will require early planning and timely execution to leverage this advantage, including managing budgets, resourcing and the overall success of the project.

However, these critical activities will clearly require significant investment by companies while they continue to focus on running their existing business operations, making this task hugely challenging. In recent months, we have seen that some Indian companies have woken up to this daunting task and are getting prepared. We are now seeing serious engagement at the C-suite level, with many companies discussing GST at the board level, identifying GST steering committees and making them accountable for executing this transformation.

We welcome this level of engagement and encourage other companies to follow suit. Starting the GST process early will help businesses to leverage the opportunities that the new tax system offers, ensure timely compliance and avoid disruption and panic at the later stages as GST day one approaches!
Consumption taxes are continuing to spread, with a number of countries announcing plans to introduce a VAT or GST system or extend the scope of their VAT system to new activities. This map highlights countries or areas that have recently introduced VAT/GST systems, those who have announced the introduction or extension of VAT/GST systems and those that are considering introducing new VAT/GST systems.

**Bahamas**
- 1 January 2015: VAT introduced at a rate of 7.5% (postponed from 1 July 2014)

**Puerto Rico**
- 1 July 2015: combined central government and municipal sales and use tax increases from 10.5% to 11.5%
- 1 October 2015: VAT of 4% on professional services (currently exempt)
- 1 April 2016: intending to implement VAT system to replace existing sales and use tax system

**Suriname**
- 1 January 2016: VAT due to be introduced (postponed from 1 January 2014)

**Costa Rica**
- 2016: Planning to implement VAT system to replace GST system. VAT rate of 13% in 2016, rising to 15% in 2017
Malaysia
1 April 2015: GST at rate of 6% implemented to replace existing sales and services tax

India
1 April 2016: proposed introduction of new indirect tax regime consisting of central GST (CGST) and state GST (SGST)

Egypt
Introduction of VAT law to replace existing GST system announced; however, implementation date not yet confirmed

China (mainland)
2015: VAT expected to be extended to real estate and property, financial and insurance services, and lifestyle services by late 2015 or early 2016
1 March 2015: credit system introduced for enterprises claiming tax refund on export

GCC
Agreement has been reached on introduction of VAT; further details regarding implementation date or rates of tax have not yet been provided

August 2015
Italy

new VAT “split payments” for public administrations

Following the enactment of the “2015 Stability Law,” Italy has introduced a specific split-payment mechanism for VAT due on goods and services supplied to the majority of government and public sector bodies (referred to in this article as public administrations).

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1. Law No. 190/2014.
The “split-payment” mechanism

The new so-called “split payment” mechanism applies to supplies of goods and services carried out from 1 January 2015. It applies only to domestic transactions carried out by suppliers for sales to eligible Italian public administrations.

According to the new provision, while the supplier is still required to issue invoices showing the relevant VAT due, the public administration purchaser is required to pay the VAT directly to the Italian Treasury and not to the supplier. Basically, the public administration has to “split” the payment by paying the consideration for the transaction to the suppliers and transferring the VAT due directly to the Italian Treasury.

The new mechanism, together with other recent measures expanding the scope of application of the domestic reverse charge, has been introduced to curtail VAT evasion and prevent fraudulent practices. Indeed, the application of this new payment system should greatly reduce the risk of suppliers not paying VAT charged to public administrations because the tax due will be transferred directly to the Treasury.

Therefore, the new system should reduce VAT evasion and increase the funds available to the Italian Revenue. However, suppliers who deal with public administrations may suffer several negative consequences such as being in a VAT credit position and incurring additional administrative costs to obtain refunds.

How do the new measures apply?

The Italian tax authorities have recently provided detailed guidance about the new payment system, which clarifies certain aspects of whom they apply to, what supplies are covered and when payment is due.

Public administrations subject to the new payment system

The tax authorities have clarified that the new payment system applies to Italian public administrations as defined in the VAT law, but with additional interpretation (e.g., public universities, public hospitals and social security bodies). In addition, they have clarified that the new payment system applies irrespective of whether the eligible public administration is acting in its commercial or institutional capacity in making the purchase. On the other hand, the split-payment mechanism does not apply to social security bodies that are not of a public nature, nor does it apply to noneconomic public entities.

Finally, the explanatory letter states that the subjective requirement of the provision is fulfilled by the public nature of the body itself, and not by the type of service offered to it.

Supplies subject to the new payment system

The split-payment mechanism generally applies to all taxable supplies of goods and services supplied to eligible public administrations. However, specific exceptions apply, such as:

• Transactions where the public administration is not liable for the payment of VAT (e.g., VAT-exempt supplies, supplies outside of the scope of VAT and supplies certified by a ticket or a simple receipt)
• Supplies subject to the reverse-charge mechanism
• Supplies of professional services (e.g., services rendered by lawyers and engineers)

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4. In accordance with Article 6, 5) of Presidential Decree No. 633/1972.
Time of supply and accounting for VAT

The time of supply (i.e., the tax point) for the VAT on supplies of goods and services subject to the split-payment mechanism is the time of payment of the invoice. However, public administrations can apply to treat the receipt of the invoice as the tax point.

Invoicing

It is important to note that, with effect from 31 March 2015, supplies to all public administrations in Italy are subject to mandatory electronic invoicing and electronic archiving (see our article on this topic in Indirect Tax Briefing Issue 115).

Suppliers

For supplies that are subject to the split-payment mechanism, the supplier must issue the relevant invoice indicating the applicable VAT amount and indicating that the regime applies. Specifically, the invoice must contain a reference that it is subject to the scissione dei pagamenti (i.e., split payment).

Suppliers do not have to include the VAT amounts for split payment invoices in their periodic VAT calculations; however, they should still indicate supplies made to public administrations and the applicable (unpaid) VAT amounts in their periodic VAT sales ledgers.

Taxable public bodies

Public administrations that make purchases for commercial purposes must register the relevant invoices both in their VAT sales ledgers and in their VAT purchases ledgers. Registration must be done by the 15th day following the month when VAT becomes due, but with reference to the previous month. As a consequence, VAT paid via the split-payment mechanism is offset with deductible VAT resulting from the same purchases and from others carried out in the reference month.

Non-taxable public bodies

Public administrations that carry out purchases for institutional purposes can use the split-payment mechanism to pay VAT in one of the three following ways:

1. On a one-off basis, by paying the VAT due separately for each invoice as the VAT becomes payable
2. Daily, by paying the total VAT for all the invoices for which VAT has become payable on that day
3. Monthly on the 16th of each month, by paying for all the invoices for which VAT has become payable during the previous month

VAT refunds

Public administration suppliers that mainly carry out transactions subject to the split-payment mechanism should normally be in a VAT credit position (i.e., because their input tax on purchases exceeds their output tax on sales). Being in a VAT credit position may cause severe cash flow issues due to delays in obtaining VAT refunds. To reduce the negative financial effect, public administration suppliers are entitled to file VAT refund claims on a quarterly basis, and they have priority in receiving repayments.

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5. Available at www.ey.com/indirecttaxbriefing.
Conclusions

The split-payment mechanism introduced on 1 January 2015 seeks to reduce VAT evasion and prevent fraudulent practices. It is one of a number of similar measures introduced recently, including expanding the scope of the domestic reverse charge and mandatory electronic invoicing. It seems likely that it will achieve this goal, by ensuring that a large amount of VAT is paid directly to the Treasury.

However, the new payment system may cause public administration suppliers to suffer severe negative cash flow and cost consequences arising from being in a VAT credit position and from the additional administrative costs linked to VAT refund claims (such as the mandatory provision of bank or insurance guarantees and tax certification).

Recovering input VAT is likely to be the most significant issue in practice, especially for businesses that mainly supply their goods and services to public bodies. Due to the split-payment mechanism, business suppliers dealing with public administrations would need to recover input VAT of around €15 billion, according to recent studies, indicating the potential size of the issue. Therefore, it is a matter of priority for businesses operating with public administrations to proactively look at the impact of VAT cash flow and to implement the available measures provided by the Italian VAT law to optimize their VAT credit position, including making quarterly VAT refund claims, VAT offsetting, the sale of VAT credits and VAT grouping.
Russia

new VAT return brings new challenges

The Russian tax authority introduced a new format for VAT returns effective from 2015.¹ In this article, we look at some of the key aspects of the new return, reasons for its introduction and the additional VAT audit scrutiny that taxpayers may face in Russia in the future.

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The new Russian VAT return

Russian VAT-payers were required to submit VAT returns for the first quarter of 2015 using the new VAT form. Returns were required to be submitted by 27 April 2015.

The format of the VAT return has changed significantly. There is a shift to transactional VAT reporting, whereby information about every incoming and outgoing VAT invoice for the period must be included in the return. In addition, all VAT returns must be submitted to the tax authorities electronically in XML format, and they must be transmitted using special software.

Combatting missing trader fraud

One of the key reasons why the tax authorities have introduced the new VAT return is to combat missing-trader fraud. Missing traders are companies that lack substance that receive paying output VAT. The information that the tax authorities now obtain from the new VAT return allows them to see the whole supply chain from import or production to the final customer. As a result, they can easily find the “gaps” in the supply chain and spot missing traders.

The new return makes it more important than ever for bona fide Russian companies to check carefully the background and reliability of new and existing subcontractors. In an earlier issue of Indirect Tax Briefing, we wrote about missing traders and actions that taxpayers should take in these circumstances. In our experience, one of the most efficient ways for bona fide taxpayers to protect themselves is to have robust internal policies and procedures for accepting new suppliers and to align them with the standards used by the tax authorities.

Taxpayers’ experience of the new return

Russian businesses generally agree that it is no longer a problem to convert their data into the requested XML format and to formally comply with the requirements of the tax legislation. However, there is another task that is not so easy: passing all the control procedures used by the Russian tax authorities and ending up with no assessments!

When preparing the VAT return for the first quarter of 2015, Russian businesses faced substantial difficulties, such as:

- Poor-quality data input into ERP systems creates difficulties for automated filing. Input data that contains mistakes or that is in the wrong format may require huge manual efforts to correct it, which can greatly add to the time and cost needed to submit the return.
- The VAT methodology (i.e., the methods used to decide on the VAT treatment of a transaction —whether it is subject to VAT, the correct VAT rate or the correct VAT base) adopted and used for many years for some transactions may not comply with the new requirements of the tax legislation. Some taxpayers decided not to change their methodology for the first quarter due to limited time, but now this issue must be addressed for upcoming tax periods. The methodology issue is likely to become even more significant in view of the plans of the tax authorities to introduce differentiated checks for each type of transaction (e.g., output VAT on prepayments, recovery of import VAT and reverse-charge VAT).
- The tax authorities have developed control ratios that enable the software they use to automatically check the amounts in taxpayers’ reports. These control ratios are public, and every taxpayer may check if its data complies with them. However, in our experience, it can be a complicated task to find the mistake that has led to the breach of a control ratio. Again, this issue is likely to become more significant, as the tax authorities have recently stated that, in the future, VAT returns that do not comply with the control ratios will not be accepted.

2. Indirect Tax Briefing, Issue 10, at ey.com/indirecttaxbriefing.
More data leads to more tax authority scrutiny

To support this project, the tax authorities have opened a data processing center that allows them to consolidate all the data related to taxpayers and to maintain taxpayers’ individual tax histories.

Having large volumes of accumulated data about taxpayers, together with strong data processing capacities, provides the tax authorities with numerous opportunities to analyze taxpayers’ transactional data from the new VAT returns is another element in this modern tax control framework that has been implemented by the Russian tax authorities. Important features of this control system include:

- Automated “risk-oriented control procedures” that assign a particular level of risk to each taxpayer, from red (high risk) to green (low risk). The classification will serve as a basis for carrying out future tax audits.\(^4\)
- Effective from 2013, the tax authorities have been collecting electronic transfer pricing notifications about transactions between related parties.
- The tax authorities have had access to the database of the customs authorities for a number of years. They will continue to use this information, in conjunction with information from VAT returns and transfer pricing reports.

Once these sources of taxpayer data are all consolidated, the tax authorities will have a complete picture of the tax profile of every business. It is clear that businesses operating in Russia should be aware of this trend and be ready to face this level of audit scrutiny.

Changes in the desk tax audit procedure

The introduction of the new VAT return has also given the tax authorities more power to carry out desk audits. Effective 1 January 2015, if, during a desk tax audit, the tax authorities notice a mismatch between the data shown in the taxpayer’s VAT return and the data contained in a VAT return submitted by the taxpayer’s counterparty, they are authorized to:

1. Request the VAT invoices, primary records and other documents related to the transactions for the reporting period.
2. Visit the taxpayer’s place of business and inspect the documents, sites and premises used for entrepreneurial activities. Previously, the tax authorities could perform this type of tax control only within the scope of a field tax audit.

The existing powers of the tax authorities to ask for additional clarification from taxpayers have also been expanded. In some cases, the tax authorities are entitled to block a taxpayer’s bank account if it does not react to a request for information on a timely basis. Moreover, the tax authorities have developed special forms for information requests and for taxpayers’ responses. Requests will be generated and sent to taxpayers automatically, and responses should be submitted in an approved electronic format (i.e., in XML format and submitted using special software).

What should taxpayers do?

The new VAT return form introduced in Russia and the related tax authority scrutiny of taxpayers’ records make it crucial for businesses to review their VAT processes thoroughly. Businesses must consider processes and controls at every stage, from entering data into the ERP system to the preparation of the final VAT return.

In view of the changes, businesses operating in Russia may consider taking the following actions:

- Undertake quality control checks on the procedures for inputting data into the ERP system
- Consider implementing electronic document flows with counterparties
- Regularly perform data reconciliations with counterparties to help prevent data mismatches
- Revisit the VAT methodology established in the company and amend it to comply with the VAT legislation
- Develop internal automatic data analytic procedures to verify the accuracy and completeness of data reflected in the VAT return
- Fully automate the preparation of VAT returns
- Automate the procedure to respond to requests from the tax authorities

New VAT/GST regimes: driving business transformation

The introduction of a new value-added tax (VAT) or goods and services tax (GST) is a major event for tax administrations and taxpayers alike. New tax rules bring uncertainty and increase the risk of errors and disputes. Designing and implementing the new tax into legislation and business systems and processes requires significant work in the months ahead.

This webcast was broadcast on 25 March 2015 and focuses on five countries that are planning, extending or considering implementing VAT/GST in the next 12 months: Malaysia, India, China, Egypt and Puerto Rico.

What is changing, and whom will it affect? What are the implications? What should you be doing if you operate in these jurisdictions?

Replay the webcast at:

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Indirect Tax Briefing — August 2015
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