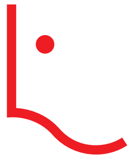

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ENTERPRISE COST MANAGEMENT

SEPTEMBER 2011

VAT & I-TAX News

BI-MONTHLY MAGAZINE

EDITORIAL

Adapting to change is always a challenge and businesses have to face it every day. Lowendalmasaï wishes to support its clients in this process and how better to achieve it than constantly re-evaluating our own ways of thinking. In our newsletter of May 2010, we first demonstrated this by changing the name and the content of our VAT newsletter to include customs and international tax subjects. Today, our newsletter continues in this spirit and gives international taxation the place it deserves by renaming it "VAT and I-TAX News". This aims to emphasize the new Enterprise Costs Management approach of Lowendalmasaï by considering all potential taxation subjects including, in addition to VAT and customs, international taxation matters such as transfer pricing. We truly believe that our constant update of tax news and new tax opportunities is one of the keys to best serve you.

CONTENTS

Edito 1

Main article 2

News 3

VAT Chart & contacts 4

Tour Operator Margin Scheme for travelers only

The EU Commission has finalised its discussions with nine member states regarding the application of article 306 of Directive 2006/112/EC that defines the VAT margin scheme applicable to travel agencies and tour operators. Eight of these member states (Poland, the Netherlands, Portugal, France, Italy, Finland, Greece and the Czech Republic) are now deferred by the Commission to the EU Court of Justice for inaccurate transposition of the margin scheme regime into their legislation.

The VAT margin scheme has been implemented to simplify the VAT duties of travel agents who sell travel packages to travelers. This is where the key question lies: what is a traveler? The EU Commission considers that margin scheme cannot apply to "travel agents who sell holiday packages to other taxable persons, in particular travel agents who resell the travel services" (IP/08/333 – 28/02/2008). Apart from the Netherlands that allows an option for the normal VAT rules, all member states involved in this litigation have introduced a general margin scheme regime for travel agencies that disregard the status of the customer and therefore, give unfair competitive advantages to non EU travel agents who do not apply EU VAT on invoices to EU residents. This creates an uneven application of the rules between Member States and thus a distortion of competition.

Tour Operator Margin Scheme for travelers only

Who qualifies as a traveler?

The margin scheme appears to be convenient for travel agencies selling travel packages to private individuals. It allows taxation in the country where the travel takes place since it prohibits VAT recovery of the VAT incurred on the local expenses (accommodation, food, transport) and allows the travel agent to charge its domestic VAT only on his margin without being obliged to register in the country where the travel takes place. Moreover, this system limits the distortion of competition based on the differences of VAT rates throughout the EU.

But in many cases travel agencies act as an intermediary between local suppliers (hotels or restaurants for instance) and a foreign travel agency reselling the travel locally. This is where the EU Commission seeks a stricter application of the margin scheme: to interpret the VAT Directive so that the travel agency of the country of the travel cannot use the margin scheme but should instead charge local VAT to a reseller who is not the traveler (under the margin scheme or not). The local travel agency has to adhere to the normal VAT rules on services and thus use the reverse-charge rule or taxation in the country of the service (accommodation, transport and restaurant) with a risk of multiple VAT registrations where the services are rendered. This means a lot more complexity for travel agencies to manage properly the EU VAT rules.

How about the 2002 proposal of Directive?

A primary understanding of this action could be that the Commission seeks for more complexity through a rigorous application of the VAT Directive. But the real purpose of this action is a long-term improvement of the existing EU legislation on the tour operator margin scheme. Indeed, since the interpretation of this regime varies significantly throughout the EU with double taxation issues and distortions of competition, the Commission proposed in 2002 a draft of amendment to this margin scheme regime in order to simplify and update it (COM(2002) 64). With this proposal, the Commission suggested broadening the scope of the margin scheme to allow travel agencies to apply VAT to their profit margin for services sold to other travel agencies as well as to private individuals. Denmark, Ireland and the Netherlands would no longer be allowed to exempt tour operators from VAT, and Belgium could no longer allow an “all-in” method of margin calculation. Moreover, tour operators established outside the EU would also have to be VAT registered when selling package tours to customers established in the EU and collect VAT in the EU Member State where the customer is established with a one-stop-shop registration and reporting method. The third improvement would concern sales to businesses acting as travelers.

The business travel market for seminars and congresses has significantly grown from almost nothing when the tour operator margin scheme was implemented in 1977 to its billion-Euro market today. The VAT on these expenses is of major concern for these businesses faced with finding a way out of the VAT jungle to recover their input VAT. Likewise, travel agencies are fielding more and more questions about the recovery of VAT when proposing their services to taxpayers since it represents a significant part of the price proposed. Today, when businesses order a travel package from a travel agent, they are not allowed to deduct the VAT included in the cost of the package, even though they should normally be able to deduct VAT on such services if used for business purposes. Their interest is then to deal directly with local suppliers (hotels, restaurants, transporters) or to arrange an agent contract with a travel agency that allows a direct invoicing from the local supplier to the business customer but with a lot more complexity in the organization of the travel and of the flow of invoices and payments.

The Commission’s project would allow travel agencies to opt for the application of the general VAT rules: taxation in the country where the service is rendered for hotel, restaurant and transport (with a local VAT registration obligation), or taxation where the customer belongs for all other services. Regarding the latter, packages including services that belong to different taxation rules should be very attractive since they qualify as complex services and are taxable under the main VAT principle, i.e. where the customer belongs and thus without VAT when the seller and the customer are not established in the same country.

Unfortunately, the chances of this project of Directive to be enforced remain weak and there has not been much discussion on the subject over the past nine years; however, it is possible thatthe current litigation will propel the EU Counsel to move forward on this proposal and ensure an efficient and necessary harmonization of the tour operator margin scheme in the EU.

COUNTRY NEWS — Italy

Clients – Suppliers List, a new Italian obligation

The fight against tax fraud in Italy is getting stronger every day thanks to the adoption of a new set of fiscal obligations.

After the so called " Black List Declaration," a new obligation implemented by the Italian tax office aims to cross-check revenue and spend declared by both companies and private individuals: "Comunicazione delle operazioni rilevanti ai fini Iva", which translates to: "Communication of the VAT-relevant operations".

Based on the Law Decree n° 78 of the 31st May 2010, all VAT relevant operations carried out in Italy with a taxable amount greater than € 3,000 must be declared electronically on a yearly basis to the tax office.

To avoid a further burden for tax payers, the tax office has excluded from the obligation those transactions already declared in Intrastat return, "Black List returns" added to import and exports operations, insurance agreements, utilities contracts and sales to private individuals paid by credit cards.

All other transactions are subject to the obligation, including those having a taxable amount lower than € 3,000, but refer to contracts and agreements having a yearly value higher than the aforementioned threshold.

For the first submissions referring to the year 2010, the tax office has adopted two temporary measures: an extension of the dead-line from the 30th April to the 31st of October 2011; and the increase of the threshold from € 3,000 to € 25,000.

After this first test, the regular dead-line will be on the 30th April of the following year i.e. by the 30th April 2012, all transactions higher than € 3,000 relating to the year 2011 will have to be electronically declared via the tax office's software.

EUCJ CASE LAW — Worldwide VAT deduction prorata?

Preliminary ruling on case Crédit Lyonnais - CE 07/11/2011, n° 301849

A French bank tried to include the turnover with its non-EU establishments in the calculation of its prorata so as to increase its VAT deduction right. The tax administration contested this position by quoting FCE bank (C-210/04 – 23/03/2006) and recalled that the branch of a non-resident company is not independent and therefore, there is no legal relationship between them so they must be considered as one and the same taxable entity.

The French bank turned this statement to its favor and argued that according to this case law, it should be able to include its branches' turnover in its prorata.

The French Administrative Supreme Court has decided to refer this case to the ECJ so that the question of an EU or worldwide prorata can be solved, i.e. should the calculation of the VAT deduction prorata of the main establishment include the turnover of branches established in the EU and/or outside the EU? What about divergent interpretations throughout the EU (especially in light of the notion of distinct business segments)? And finally, should this EU or worldwide prorata concern all expenses? There are many practical obstacles for the implementation of a worldwide prorate, and it will be very informative to see how the ECJ manages to interpret the rules in this area.

TRANSFER PRICING — Transfer pricing and developping countries

EU Commission's study release

On July 2011, the European Commission released a new study on Transfer Pricing and developing countries (http://ec.europa.eu/europeaid/what/economicsupport/documents/transferpricingstudy_en.pdf). This study presents recommendations on suitable approaches for supporting developing countries in order to enhance domestic resource mobilization in line with the principles of good governance in the tax area.

The issue has gained recognition as a central challenge to developing countries' capacity to effectively tax multinational corporations.

The study outlines the current situation with regard to TP and challenges in selected developing countries, namely Ghana, Honduras, Kenya and Vietnam, and based on this makes recommendations for future donor support to developing countries in this area. Notably, it stressed the preconditions for the implementation of a TP reform, such as the broadening of treaty networks and practice in their application, the identification and pooling of local comparables, the building of TP expertise, and adequate control mechanisms.

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EUCJ CASE LAW

Payment: a condition for VAT deductibility ?

In C-274/10 - EC v Hungary, the ECJ ruled that the refund of VAT credits cannot be contingent on the payment of the invoice since it would assimilate making the right to VAT deduction conditional on payment. Member States are not allowed to make payment for a supply as a condition of deduction, except where payment creates a tax point.

In this case, the Commission pointed out that output VAT becomes due on the date of the delivery or supply, irrespective of whether the supplier has been paid or not. Similarly, input VAT must be deductible in the hands of the customer on the same date without any payment criteria. Otherwise, the Treasury would be unduly enriched and it would be cash burden for customers. The restrictions to the principle of fiscal neutrality can only concern the procedure, not the substance of the right of deduction. Moreover, the VAT Directive provides that the excess must be refunded at the latest during the second tax period following the tax period in which it arose. This last condition is not respected by the Hungarian legislation in which the VAT excess can be carried forward several times without any limits.

On the other hand, Hungary insisted on the fact that its legislation only determines the moment the refund becomes possible, not its principle. The absence of a payment condition would lead the State to grant an interest-free loan to taxable persons.

The court ruled that Article 167 of Directive 2006/112 states that the right of deduction arises at the time the deductible tax becomes chargeable, i.e. once the transaction has been carried out, regardless of the payment of the consideration. Furthermore, Article 168(a) expressly states that the right to deduct input tax which the taxable person enjoys relates not only to the VAT paid but also to the VAT due.

VAT CHART (September 2011) - *Normal VAT rate applicable in EU*