



meridian

VAT trends

September/October 2008

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CHINA

VAT reforms announced

Given the exceptional crisis in the global financial market, the Chinese state authorities have announced a fiscal plan of action with 10 measures to combat the effects of the economic global downturn. The plan will provide a platform of economic stimulation with levels of investment expected to exceed RMB4 Trillion (US \$586 Billion) and will be implemented in full by 2010.

Reform of the VAT system is one of the fiscal measures. We have outlined some of the major changes coming in the New Year and the newest changes to the export refund rates in China. For all companies conducting business or importing goods from China, this is a most welcome Christmas present.

Deduction for fixed assets

The Chinese Ministry of Finance and State Administration of Taxation organised a press conference on 11 November 2008 during which they revealed the details of the VAT reform.

One of the major changes is the introduction of deduction of VAT incurred on fixed assets, which so far has not been possible in China.

The deduction of VAT on fixed assets will only be applicable for new equipment purchased after 1 January 2009 and the following fixed assets will be deductible:

- machines
- machinery
- means of transportation (not small motor cars, motor cycles and yachts)
- tools and utensils related to production and operation.

Furthermore, it has been announced that immovable property, such as buildings, will not be deductible.

Any manufacturers or businesses that make large investments in fixed assets will be able to offset value added tax payments owed to the Chinese tax authorities, i.e. no direct payment of excess input VAT.

It is expected this measure will combat the slow down in technological advancements due to deficient investments in the area of fixed assets, which has been a factor in the lower growth of the national economy (down 1.8% in the first half of 2008 when compared with last year).

Removal of rules on VAT exemption for imported equipment

Unfortunately, it was also announced at the press conference that the previous rules on VAT exemption for imported equipment from overseas has been abolished due to unfair tax treatment between foreign and domestic enterprises.

Rules on refund of "Chinese origin" equipment

The previous preferential VAT treatment for domestically made equipment will be cancelled, as the input VAT incurred in the future should be refundable due to the new rules.

All in all, the changes are very positive and may financially boost companies conducting business in China.

Changes to export refund rates

By way of introduction, the Chinese operate a VAT export system where the right to deduct input VAT incurred on the goods being exported depends on what category the goods fall within. This is contrary to how it works in most countries, where input VAT is always fully refundable. In many ways the Chinese system is similar to a reverse customs duties system.

The Chinese changed the refund rates with effect from 1 August 2008, changed them again with effect from 1 November 2008 and are now changing them once more with effect from 1 December 2008. The good news is that, in almost all of the cases, the refund rates have been increased.

The following table provides a summary of some of the changes that have occurred in 2008. The list is not exhaustive, and if you would like confirmation of what



CHINA

Changes to export refund rates (continued)

rate applies to a particular product, then please contact us for further information.

1 August 2008 (Circular 111)

Category	Refund rate %
Bamboo products	11
Textiles and clothing	13
Agricultural pesticides, rosin, silver products, batteries,	No refund anymore

1 November 2008 (Circular 138)

Category	Refund rate %
Plastic products	9
Furniture	11 / 13
Ornamental ceramics	11
Textiles, garments and toys	14
Notebooks, books, sewing machines, toughened glass, tantalum wire, fans, yellow collagen products, insulin, anti-aids medicine, chains	9 / 11 / 13

1 December 2008 (Circular 144)

Category	Refund rate %
Rubber and forestry products	9
Modules and glassware	11
Chemical products, articles of stone, non-ferrous metals	11 / 13
Handbags, headgear, footwear, umbrellas, furniture, lamps, bedding, lamps, clocks and watches	13
Aquatic products	13
Mechanical and electrical products	11 / 13 / 14



CZECH REPUBLIC

Group VAT Registration

The possibility to register a group of companies as a VAT group was introduced into Czech legislation in January 2008. Group registration is optional but can reduce administrative costs and improve cash flow.

In order for a VAT group registration to be effective from 1 January 2009, the application had to be submitted to the tax office of the head of the VAT group by 31 October 2008. The VAT group will receive a new VAT number in the format CZ699xxxxxx and previous VAT registrations of the VAT group members will be automatically deleted once the new registration is in place.

In VIES (the VAT Information Exchange System) the VAT group will be identified under the new VAT number and will contain information of the head of the VAT group.

Withdrawal of 50-heller coins

With effect from 1 September 2008, the Czech 50-heller coin ceased to be legal tender. As a result, a temporary regulation has been introduced stipulating that the VAT amount for cash payments should be mathematically rounded to the nearest unit of currency, which is the Czech Crown (CZK). This will apply for a transition period, which will last from 1 September 2008 until 31 December 2008.



FRANCE

Exemption for international airlines

Exemption applicable to goods and services supplied for the needs of aircraft used by airlines whose international operations represent 80% of their overall activities.

The French Administration has published an updated list of airlines that are deemed to benefit automatically from the specific exemption from VAT on the following purchases:



FRANCE

Exemption for international airlines (continued)

- Services consisting of the modification, repair, maintenance, chartering and hiring of aircraft;
- Goods for the fuelling and provisioning of aircraft;
- Any other services that are to meet the direct needs of the aircraft and their cargoes.

Any company that is not on the list can benefit from the same exemption, but they will have to prove to the administration that they fulfil the relevant conditions.

The list of companies can be found on line at the following link: [3 A-5-08](#)



GERMANY

Proposed changes - Tax Amendment Act 2009

The German government has recently announced the following changes to the German VAT Act, effective 1 January 2009:

1. Supplies into a free port

Under certain conditions, supplies into a free port (a free port is a special customs area) may be treated as VAT exempt with credit in the same way as an export transaction.

An amendment has been prepared stating that, where the recipient uses the goods delivered into the free port for exempt transactions (exempt without credit) the initial supply cannot be treated as tax exempt.

2. Bookkeeping records transferred abroad

More and more companies are carrying out their business globally and therefore it is sometimes desirable to transfer the accounting books and records abroad. Up until now, the national German legislation did not allow accounting records to be kept abroad.

From January 2009, however, it will now be possible to have at least the electronic data processing located in another EU Member State, as well as in some of the states of the European Economic Area.

3. Abolition of the obligation to issue invoices in respect to certain supplies

Germany has put an end to the obligation for businesses to issue an invoice in respect to supplies of goods or services that they have made in Germany which are exempt, with or without deductibility of related input VAT. This does not apply to intra-Community supplies and exports, however, where the obligation to issue an invoice remains unchanged.

4. Abolition of the obligation to issue a paper invoice when EDI is used

Where invoices are transmitted via electronic data interchange (EDI) it is currently a requirement to subsequently issue a collective invoice, either in hard copy or electronically. This requirement is now to be abolished.

5. Increase of threshold for submitting monthly VAT returns

Businesses that make taxable supplies in Germany will be obliged to file preliminary VAT returns on a monthly basis if the amount of VAT that they had to pay in the previous year exceeded EUR 7,500 (previously EUR 6,136).

Below this threshold, businesses can choose to file monthly preliminary VAT returns (as opposed to quarterly returns) by submitting a request to their local tax office.

If the amount of VAT that they had to pay in the previous year did not exceed EUR 1,000 (previously EUR 512) businesses may not need to file any preliminary VAT returns at all, only the final (annual) VAT return.



IRELAND

New VAT Rules for Construction Services

Relevant Contracts Tax (RCT) applies to sub-contractors in the construction, forestry or meat processing industries.

It is a system of tax deduction whereby the principal contractor deducts tax at 35% from the gross payment (including VAT) made to the sub-contractor. Sub-contractors can avoid RCT deduction provided they have a certificate of authorisation (a C2) and the principal contractors receive a Relevant Payment Card for them from the tax office. RCT applies to both resident and non-resident sub-contractors.

From 1 September 2008, a new system was implemented regarding how principal contractors and sub-contractors in the construction industry will account for VAT.

Prior to 1 September, the invoice from the sub-contractor should have reflected the consideration plus VAT. The principal paid the sub-contractor for the services, and unless the principal contractor held a Relevant Payment Card, he was required to deduct RCT at 35% from the full payment including VAT. The sub-contractor then passed on the VAT to the Revenue Commissioners.

After 1 September 2008, invoices issued by sub-contractors should no longer include VAT. The invoice should only include the VAT number of the sub-contractor and the statement that VAT will be accounted for by the principal contractor. The amount paid by the principal contractor to the sub-contractor will not include VAT, and if RCT is to be deducted, it is to be calculated on the VAT exclusive amount. The principal contractor must then calculate VAT on the amount charged by the sub-contractor and pay the VAT directly to the Revenue Commissioners through his VAT return using the reverse-charge mechanism.

These changes mean that government departments, local authorities and public bodies who are principal contractors for the purposes of RCT will now have to register for VAT, and account for VAT on services

received from sub-contractors directly to the Revenue Commissioners via their VAT returns.

Businesses established outside of Ireland, whose only supplies are supplies to principals, will no longer have an obligation to register for Irish VAT, however they will need to register if they wish to claim any input VAT.

The new system will apply only to invoices issued after 1 September 2008. The VAT rules for construction services that are not subject to RCT remain unchanged.

Standard Rate of VAT to Increase

With effect from 1 December 2008, the standard rate of VAT in Ireland will be increased from 21% to 21.5%. The increase was announced as a part of the annual budget on 15 October 2008.



ITALY

Proposal for VAT exemption for Italian SMEs.

In an endeavour to create a more business friendly environment for small and medium enterprises, Italy has sent a formal request to the European Commission to exempt businesses whose annual turnover is less than EUR 30,000 from VAT. The scheme would be voluntary for businesses.

VAT deductible on Hotels and Restaurants

From 1 September 2008, VAT charged on hotel and restaurant bills in Italy is fully deductible if incurred by local and foreign businesses in the course or furtherance of their taxable activities. This new rule amends previous Italian legislation, which restricted the deduction of VAT paid on such expenses.

Businesses wishing to take advantage of the new rules must ensure that they obtain an original invoice showing the full legal name and address of the company.



ITALY

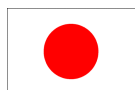
8th Directive claims for non-residents that carry out taxable activity in Italy

The Italian VAT authorities have issued a ministerial resolution (N. 17/E, dated 24th January 2008) which removes the need for non-resident businesses that make certain supplies in Italy to get registered for Italian VAT in order to reclaim any local VAT that they incur on purchases and expenses. The resolution is an extensive interpretation of the conditions applicable for a refund of VAT under the 8th Directive and it has been adopted for the first time by the VAT office that deals with non-resident businesses in Pescara.

Prior to this resolution, refund claims submitted under the 8th directive would be rejected if the non-resident business supplied services that were taxable in Italy, even if the liability to account for the VAT on those services could be shifted to the Italian customer.

The resolution was issued in response to a successful appeal by a German company in relation to a rejected 8th Directive claim. The Central Office of the Agenzia delle Entrate, who heard the German company's appeal, concluded that the German entity was entitled to apply for a refund under the 8th Directive, even though it had made taxable supplies in Italy.

In practice, this resolution should drastically reduce the number of non-resident businesses that must register for Italian VAT in order to reclaim their input VAT incurred while making taxable supplies in Italy.



JAPAN

VAT on Lease transactions in Japan

The VAT treatment of lease transactions in Japan has been clarified by an amendment to tax circular no. 5-1-9 dated 25 December 1995.

The tax point for lease transactions occurs at the time when the goods have been delivered by the lessor to the lessee even if the lease transactions do not constitute a supply of goods.

Financial leases, where the title of the goods is not transferred to the lessee at the end of the transaction, became taxable under the new provisions, and the lessee will be entitled to recover the input tax at the time where the delivery of the goods is recorded in his accounts.



LATVIA

Proposal for Major Changes to the VAT Act

The Latvian Ministry of Finance has announced a proposal to amend the VAT Act, scheduled for implementation in January 2010.

The proposal includes significant changes to the VAT legislation, which are aimed to define more precisely the legal provisions that are currently in force, as well as to bring the Latvian legislation in line with the European Union VAT Directive.

The most important changes will cover the following areas:

1. VAT group registration;
2. VAT relief for bad debts;
3. Options for taxing the supply of immovable property that is no longer considered 'new';
4. Removal of the obligation to adjust deduction of VAT related to destroyed and stolen goods;
5. New tax treatment for goods imported into Latvia.



LUXEMBOURG

The issue and sale of telephone credits in Luxembourg is VAT exempt

The Luxembourg VAT authorities have published a new circular (Circular No. 736 of 29 May 2008) concerning telephone credits in Luxembourg. The circular is a response to the expanding range of products and services other than telecommunications, which can now be purchased using phone credits.



LUXEMBOURG

The issue and sale of telephone credits in Luxembourg is VAT exempt (continued)

The sale of telephone credits in Luxembourg used to be subject to the standard rate of VAT (15%) however the circular now makes the issue and sale of telecommunication credits outside of the scope of VAT, as at the time of issue or sale, the nature of the final use of the credit cannot be determined.

If the consumer subsequently uses the credit for telecommunication services, the telecommunication provider will have to apply VAT at 15% on the supply.

If the consumer consequently uses the credit to buy goods or services (other than telecommunication) this is deemed to be a direct supply between the supplier of the goods/services and the supplier will be liable for the payment of the VAT on the transaction at the applicable rate. There is no VAT liability for the issuer of the phone credit or the retailer in this situation.



POLAND

Reasoned Opinion issued by European Commission regarding exclusions to deduct VAT on certain motor vehicles and fuel & ECJ Case C-414/07 Magoora Sp. z o.o.

On 5 June 2008, the European Commission issued a reasoned opinion to Poland relating to exclusions concerning the right to deduct input VAT incurred on the purchase of certain motor vehicles and fuel. These exclusions were implemented by Poland after its accession to the European Union.

The Commission is of the opinion that the above amendments to the Polish VAT regulations are in breach of Community law, as Article 176 of Council Directive 2006/112/EC only allows Member States to retain those VAT deduction exclusions that were in force at the time when they joined the EU. It does not allow the Member States to widen the scope of the restrictions applicable to the right to deduct input VAT.

As a result of these changes in legislation, some categories of vehicles have been excluded from the right to deduct input VAT whereas this was not the case prior to Poland joining the EU. The same exclusions have been implemented to fuel that is purchased for those vehicles which, under the former legislation, was subject to the standard rules of deduction.

In light of the above facts, the European Commission has decided to take steps against Poland by means of a reasoned opinion under the provisions of Article 226 of the EC Treaty. If Poland does not address the Commission's request, a possible consequence is that the case may be referred to the European Court of Justice (ECJ).

There is currently one pending case at the ECJ (Case C-414/07) in which the Polish regional court filed a preliminary question in its proceedings with the Polish company Magoora Sp. z.o.o. The question raised was whether it was lawful for Poland to amend its national legislation (at the time of joining the EU and at a later date) so that effectively input VAT deduction rules governing purchases of fuel became stricter.

At the first hearing, which was held on 25 September, the European Commission supported the taxpayer's standpoint and expressed its opinion that Poland was completely wrong in amending its national legislation governing deduction of input VAT on fuel and passenger cars after its accession to the European Union.

If the ECJ rules in favour of the taxpayer, it could potentially create an opportunity for businesses to retrospectively recover VAT which is currently deemed irrecoverable.



PORTUGAL

Portuguese VAT Refunds

The Minister of Finance has issued Normative Order 31-A/2008 which stipulates that VAT refunds greater than EUR 10,000 must be refunded by the Portuguese



PORTUGAL

Portuguese VAT Refunds (continued)

tax authorities within 30 days of the presentation of a refund request in the following circumstances:

- The taxpayer is not submitting its first refund request (the authorities have six months in which to refund VAT in relation to a first request).
- 75% of the taxpayer's supplies are made under the reverse charge procedure.

Furthermore, the Portuguese tax administration has issued an internal instruction (Circular 14/2008), which stipulates that any VAT incurred by Portuguese taxpayers in other EU Member States cannot be considered as tax deductible for Portuguese corporate income tax purposes.



SERBIA

Refunds of overpaid import VAT

The Serbian Ministry of Finance has recently modified their rules regarding the refund of overpaid import VAT in order to establish the relevant authorities responsible for repayment of the VAT.

Prior to the modification, it was not specified whether the customs administration or the tax administration should make the repayment of the overpaid VAT. As a result, many companies who wanted to obtain refunds were never successful with their claims.

The changes, however, state that the Serbian tax administration should grant the refund of import VAT that has been overpaid. Taxpayers who wish to reclaim overpaid import VAT have to prove that the mistake was made at the time of import to the detriment of the taxpayer. Additionally, taxpayers have to submit documents issued by the customs administration confirming the fact that the VAT was overpaid.



SOUTH AFRICA

Proposal to increase VAT registration threshold

The Ministry of Finance has officially announced a proposal to amend the threshold above which businesses must register for VAT under the tax law due to come into effect on 1 March 2009.

Currently, taxpayers whose annual taxable turnover does not exceed ZAR 300,000 are exempt from registration. According to the proposal, this threshold will increase and only taxpayers whose annual sales exceed ZAR 1 million will be required to register and charge VAT.

The proposal also includes the introduction of turnover tax for businesses with a turnover not exceeding ZAR 1 million. Businesses providing professional services such as accounting, auditing, law, real estate, sport, education and consulting will not be entitled to apply for the turnover tax however.



SOUTH KOREA

Proposed changes to VAT legislation

The government of South Korea recently announced a proposal to change its tax law as part of a bill to amend the Enforcement Decree.

A reduction in the scope of VAT exemption is one of the changes to be introduced and is expected to take effect from 1 July 2009.

Additionally, the proposal introduces a consolidated tax system allowing taxpayers to elect for either the current separate tax return filing system, or the proposed new system where VAT would be imposed based on the VAT registration of taxpayers, not on the registration of individual business establishments as presently.



SPAIN

Spanish VAT numbers

An amendment to the Spanish VAT legislation (EHA 451/2008) concerning the composition of VAT identification numbers in Spain has recently come into effect.

With regard to non-resident companies, there are two special provisions outlined in Articles 2 and 3 as follows:

1. In the case of non-resident companies that require a Spanish VAT number, but do not have a fixed establishment in Spain, the Spanish VAT number must begin with the letter N, followed by eight digits.
2. However, if non-resident companies carry out economic activities in Spain through fixed establishments, the VAT number must begin with the letter W, followed by eight digits. It is important to note that each fixed establishment must have a different VAT number if it carries out different economic activities via independent management structures.

The Spanish authorities will assign the new VAT identification numbers between 1 July 2008 and 1 January 2009 to those businesses that are affected by the changes. If businesses have not received their new VAT number by 1 January 2009, they will need to approach the Spanish authorities in order to request that the new VAT number be issued.

Spanish VAT returns via Internet

On 1 October 2008, a new law came into effect in relation to Spanish VAT (EHA/3435/2007). The law imposes an obligation on any company with a Spanish VAT registration number, which carries out economic activity in Spain, to submit all their Spanish VAT returns via the internet.

To comply with this obligation, companies will either need their own electronic signature issued by the Spanish authorities or else a representative in Spain

who has an electronic signature and is authorised by the company to submit Spanish VAT returns on their behalf.

After 1 January 2009, all companies must submit their VAT returns via the internet, including all information that was used to calculate those returns.

Please contact the Meridian international VAT compliance team for further advice on this issue.



SWITZERLAND

Tax reform

The Swiss Federal Council recently proposed wide-ranging tax reform in order to simplify the tax environment in Switzerland. The tax reform is based on a completely revised VAT Act consisting of more than 50 provisions.

The main reform is the introduction of a flat VAT rate of 6.1%, as well as the elimination of many tax exemptions.

The aim of the new VAT law is to be more “customer orientated”, to support Switzerland as the economic location for businesses in Europe and to help stimulate economic growth



UNITED KINGDOM

New penalty regime

New penalties for errors on tax returns and documents

Initially, the new penalty regime applies to VAT, PAYE, National Insurance, Capital Gains Tax, Income Tax, Corporation Tax and the Construction Industry Scheme for tax periods starting on or after 1 April 2008, but only in respect of returns or documents due to be sent to HMRC on or after 1 April 2009.



UNITED KINGDOM

New penalty regime (continued)

Businesses could be charged a penalty if they do not take 'reasonable care' to make sure returns and documents are correct.

The penalty is calculated as a percentage of the extra tax due. The percentages are stepped and are higher the more serious the underlying behaviour that results in the inaccuracy.

There is no penalty if a business can demonstrate that it has taken reasonable care to ensure correct declarations and disclosure.

According to the UK tax authorities, HM Revenue & Customs ("HMRC") some of the ways a business can show it took reasonable care are:

- To take extra caution to provide HMRC with correct returns and documents;
- Maintaining good records to ensure that HRMC are provided with complete and accurate tax returns and documents;
- Asking HMRC or a tax adviser for advice if the business is not sure about any aspect of his tax affairs; and if the trader is still unsure, by
- Flagging the entry and explaining the problem when sending the return or document to HMRC.

The penalty is up to 30% of the potential lost revenue if the error is careless, up to 70% if the error is deliberate or up to 100% if the error is deliberate and the business conceals it.

Businesses can substantially reduce any penalty due if it advises HMRC about any errors before HMRC inquires about the errors, helps HMRC work out if it has overclaimed and allows HMRC to check the figures.

Limit for correction of VAT errors

With effect from 1 July 2008, the limit for being able to adjust errors on returns was raised from £2,000 to £10,000. Errors of more than this amount can also be

put right on the return for businesses with turnover for VAT purposes of more than £1 million. In this case the limit is 1% of turnover up to a maximum of £50,000. Errors in excess of these limits must be separately disclosed to HMRC.

HMRC figures suggest that this will reduce the number of notifications by around 70%.

Under the current rules, the test is purely mathematical and an error disclosed by making a voluntary disclosure is not liable to a misdeclaration penalty.

However, under the new penalty regime, a voluntary disclosure of a VAT error will not meet the definition of disclosure and thus will not protect the trader in the event of a penalty being due. According to the new penalty provisions, three elements of disclosure need to be considered.

1. Is the trader telling HMRC about their error;
2. Is the trader helping HMRC work out what extra tax is due; and
3. Is the trader providing HMRC access to the trader's records to check the calculations

The new regime will mainly focus on the behaviour of the business that gave rise to the error.

According to the new regime, if a business makes an error that has been caused by it failing to take 'reasonable care', it will still be liable for a penalty and should make an error notification (previously known as voluntary disclosure) regardless of the amount of the error. This means that some small errors will be disclosed to HMRC despite the fact that the tolerance for separate disclosure has been increased.

Businesses may consider making an error notification whether they need to or not in order to avoid problems, but this may result in interest being paid unnecessarily provided they had taken reasonable care and the amount was below the limits for adjusting a return.

New penalties for errors in claims for VAT refunds

According to a recent notification on the HMRC website, HMRC seeks to extend the application to the



UNITED KINGDOM

New penalty regime (continued)

penalty regime to VAT claims made under the EC 8th and 13th Directives.

Meridian is naturally concerned about this approach taken by HMRC, so that claimants who do take 'reasonable care' are not potentially exposed to a penalty.

It appears that HMRC seeks to impose a penalty for the request of a VAT refund, and not only in cases where a refund has been incorrectly paid. This approach would appear to be contrary to the provisions of the Directives.

We are also concerned that non-established claimants do not have the freedom, available to UK taxpayers, to withhold a 'doubtful' claim to await further information or case law or other developments that might demonstrate the legitimacy or otherwise of the claim. As a refund claim must be submitted within strict deadlines, or else be 'out of time', taxpayers are forced to file 'protective' claims in certain circumstances. This is a widespread and necessary practice across all jurisdictions.

Meridian will update readers once we have discussed the matter with HMRC in more detail, and obtained a clearer understanding of the approach that they intend to take in practice.

VAT Partial Exemption – House Builders

The housing market is slowing down, and therefore some house builders may look at the rental market as a temporary solution.

In general, if a new house is sold freehold or lease for more than 21 years, the supply is zero-rated and all VAT incurred in the costs is reclaimable. However, if a new house is temporarily let, this supply is exempt and this may result in a claw-back on some of the VAT incurred on costs.

In this case, a house builder may have to adjust the VAT previously recovered on his submitted VAT

returns, restrict the VAT to be recovered on current and future VAT returns or both, adjust VAT previously recovered and restrict current and future VAT recovery.

Depending on the amount of total exempt input tax involved, house builders may be able to take advantage of "de minimis" input tax limits. Provided the total amount of exempt input tax does not exceed

£625 per month on average (i.e. £7,500 per annum), and is less than 50% of total input tax, the builder can continue to recover all of its input tax.

If a house builder was previously fully taxable, HMRC may allow them to adopt a simple check for de minimis in respect of input tax incurred in the past years. This is based on the expected time a house builder will let a building as a proportion of the economic life of that building, which for VAT purposes is 10 years.

However, if a house builder continues to perform exempt supplies, he will need to apply a partial exemption method to determine if he remains de minimis. He can apply the standard method of calculation or seek HMRC's approval to apply a special method to reflect business transactions more precisely.

It is recommended that house builders who were previously fully taxable, and who are considering to let new residential properties, to seek professional VAT advice.



EUROPEAN UNION

Proposal on VAT reduced Rates

On 7 July 2008, the Commission set out a proposal to extend the use of reduced VAT rates across the EU. The aim of the proposal is to expand the list of goods and services for which Member States may elect to adopt a reduced VAT rate. The scope of eligible supplies has been extended to include primarily 'labour intensive' services and locally supplied services, including restaurant services.

France is a big supporter of reduced rates, especially for the catering industry, however Denmark, Sweden and Germany have always been against the measures to reduce the level of tax in Europe.

The Commission has conducted an impact analysis of the proposed changes, and has concluded that the proposal does not create a problem for the proper functioning of the internal Market.

The text of the proposed Directive can be obtained from the [Commission's website](#) (see pages 10-14).

Reciprocity agreements on VAT refunds concluded between Switzerland and Turkey / Romania

Non-established entities are entitled to VAT refunds for business costs incurred in Switzerland, providing that Swiss companies are entitled to reciprocal treatment. Recently, Switzerland entered into reciprocity agreements with Turkey and Romania. Both agreements are effective retroactively as of 1 January 2008.

Agreement with Turkey

According to the agreement on mutual VAT refunds with Turkey, Swiss businesses can apply for refunds of Turkish VAT on the following expenses:

- freight transport and purchases of fuel;
- expenses related to trade fairs and exhibitions.

Agreement with Romania

Swiss entities can apply for VAT refunds in Romania on all business costs, except tobacco products and alcoholic beverages. The standard VAT rate in Romania is 19% and reduced rate is 9% (applicable to hotel accommodation for example).

Based on these agreements, Turkish and Romanian companies are also entitled to VAT refunds in Switzerland, based on the normal rules of deduction as they apply there.

Clarification requested by the Commission on the scope of national VAT exemptions applying in Denmark, Finland, Sweden and Austria.

The Commission has requested the above countries to provide information concerning the scope of their national VAT exemptions, by launching the first stage of the infringement procedure under Article 226 of the EC Treaty.

Article 132 of the Principal EU VAT Directive provides several exemptions for certain activities that are deemed to be "in the public interest". However, it is recognised that those exemptions must be interpreted very narrowly and must be referred to on an equal basis to avoid distortions of competition between European Member States.

Following this reasoning, Denmark was asked for clarifications concerning its general exemptions applying to supplies made by charitable organisations, non-profit making associations and, under certain conditions, to second hand goods supplied by shops, which are viewed as going beyond what is allowed under Article 132 of the Directive.

Sweden's definition of "economic activity" does not refer to the criteria laid down by the Council Directive but to national criteria which is an infringement to the Council Directive and therefore needs to be clarified as VAT is due on economic activities carried out by taxable persons.

Clarification requested by the Commission on the scope of national VAT exemptions applying in Denmark, Finland, Sweden and Austria (continued).

A similar situation occurs in Finland in relation to the VAT exemption applying to entities of public interest. A greater concern, however, is that a few exemptions listed in Article 132 of the Council Directive have so far not been transposed into the national law.

Lastly, the Commission also considers the scope of the Austrian VAT exemption for certain supplies made by non-profit organisations to their members as too limited. On the other hand, the Commission considers that the exemption for services linked to sport and physical education supplied by non profit-making organisations has been implemented too widely.

Modernising the VAT rules for financial services.

The French Presidency of the EU has published some proposals to modernise the Principal EU Directive with regard to the rules for financial and insurance services which have not been significantly changed since 1977.

Article 137(1)(a) of the Directive authorises the Member States to allow businesses to opt to tax certain financial services transactions. This provision, however, does not include insurance services and only a limited number of Member states have implemented it. Therefore, the French Presidency in its endeavours to modernise the Directive has proposed that this provision be enforced more strictly by the Member states and relate to both services. The proposal also includes more details about financial and insurance services that are subject to or exempt from VAT.



Refund on costs for free meals for employees and clients?

Danfoss & AstraZeneca

General Advocate's opinion

General Advocate Sharpston has expressed her opinion in a Danish case concerning the VAT treatment of company canteen meals provided to business contacts and staff in the context of business meetings. The outcome of the case may prove to be of financial benefit for businesses all over Europe if the European Court of Justice subsequently agrees with the Advocate General's opinion.

The case essentially examines two questions:

1. Against the background of a rather complex sequence of national administrative and legislative measures, could Denmark legitimately retain an exclusion of such transactions from the right to deduct input tax on the basis of a standstill clause in the Community legislation?
2. Is such provision, when free of charge, to be regarded as an application for private use on which output VAT is chargeable if input VAT is deductible?

On the first point, the General Advocate reaches the conclusion that a Member State may not retain an exclusion from deduction with respect to expenditure for which a right to deduct was recognised by administrative practice on the date when the directive came into force, even if the exclusion was provided for in theory under national legislation. In short, the Advocate General is of the opinion that Denmark does not have the legal basis for retaining the standstill clauses today.

With regard to the second question, the Advocate General initially states that businesses should generally not be entitled to deduct input VAT related to the provision of free meals to clients and employees as these costs are not business related.

However, with regard to business contacts, the Advocate General goes on to state that the cost of providing a canteen lunch, or a tray of sandwiches free of charge to business contacts during a short break (or even without a break) in the course of a day-long business meeting does seem likely to be incurred for business purposes, i.e. to avoid the discomfort of hunger or the inconvenience and time that would be wasted by having to go out for lunch, with a resulting loss of efficiency for the meeting.

And with regard to employees, there may be circumstances in which the requirements of the job deprive the employee of choice, and indeed oblige him, for example, to eat a set meal, which may not be entirely to his taste, at his place of work in the company of business contacts with whom he is meeting or other employees with whom he is undergoing training. In such circumstances, the employee will be complying with specific requirements, which principally serve the purposes of his employer's business rather than his own private purposes. The provision of the meal free of charge by the employer should therefore not be treated as an application for private use. In summary, if it is undisputed that the costs for providing free meals to business contacts and employees serve the purposes of the business, the costs should be deductible.

Furthermore, and perhaps even more interesting, it could be interpreted that these costs should be deducted as overhead costs of the business, following the principle of neutrality, regardless of any national rules on limitations to the right to deduct, i.e. fully deductible for companies that do not have VAT exempt activities.

 **Fiscale eenheid Koninklijke Ahold NV**

 **Case (C-484/06)**

Rules used by companies to round up or down the output VAT amount

In October 2003, a Dutch company operating supermarkets in The Netherlands, Koninklijke Ahold NV, decided for internal purposes to use a different method to round the VAT in two of its supermarkets. They decided to round the VAT per item instead of rounding the VAT per till receipt (a method referred to as “rounding per basket”). They realised that application of the new method would have led to a significant decrease in the amount of VAT they had already declared to the Dutch tax administration, therefore they asked for a refund of the difference. The request was rejected by the Dutch tax authorities and the dispute went up to the Dutch High Court who decided to refer two questions to the European Court of Justice (“ECJ”).

The two questions raised were the following:

1. Should national law solely govern the rounding of VAT amounts or is it a matter of Community law?
2. And, if it is a matter of Community law, are the dispositions of Article 22(3)(b) tenth indent and (5), and Article 11A of the Sixth Directive, including rules that would require Member States to allow a method based on the rounding down of VAT per article even if different supplies are included in one invoice or VAT return?

Regarding the first question, the Court ruled that the First and Sixth Directives did not contain explicit rules concerning the rounding of VAT amounts. As a result, it is up to the Member States to determine the method that should be used to round a VAT amount so long as it respects the principles of Community law.

To the second question, the Court responded that Community law does not create an obligation for any Member State to allow taxable person to round down the amount of VAT on a per item basis.

So this decision does not set a method that shall be used to round VAT amounts but merely provides limits

that Member States should not break when recommending a specific rounding method. Any method should aim at reaching an amount which should be as close as possible to the amount of VAT arising from the application of the rates in force in the country, and in any case it may never result in an amount of VAT being due that is greater than the actual amount due.

Judgement of the Court on 10 July 2008 in Case C-25/07 Alicja Sosnowska v Izba Skarbowa we Wrocławiu Osrodek Zamiejscowy w Walbrzychu

In our November/December 2007 and January/February 2008 edition of VATtrends, we reviewed the preliminary hearing and implications of European Court of Justice Case C-25/07. In our March/April 2008 issue, the opinion of the Advocate General was presented and the final judgment of the court has now been handed down.

The court ruled in favour of the applicant, Ms Sosnowska, who brought action against the Director of the Tax Chamber in Wrocław. The action was in relation to the lawfulness of a provision of the Polish VAT Act which extends the time limit for repayment of excess input VAT related to intra-Community transactions from 60 days to 180 days in certain circumstances. The new time limit applies to businesses that have been trading for less than 12 months and that are unable (or unwilling) to lodge a security deposit totalling PLN 250,000 (approximately EUR 80, 000) with the Polish authorities. The Polish government argued that the measures were put in place to prevent tax evasion.

The Court announced the following judgment:

“1. Article 18(4) of the Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes (...), and the principle of proportionality preclude national legislation, such as that at issue in the main proceedings, which in order to allow investigations required to prevent tax evasion and avoidance, extends from 60 to 180 days, as from the date of submission of the taxable person’s VAT return, the period available to the national tax office for repayment



Judgement of the Court on 10 July 2008 in Case C-25/07 Alicja Sosnowska v Izba Skarbowa we Wrocławiu Osrodek Zamiejscowy w Walbrzychu (continued)

of excess VAT to a category of taxable persons, unless those persons lodge a security deposit to a value of PLN 250 000.

2. Provisions such as those at issue in the main proceedings do not constitute 'special measures for derogation' intended to prevent types of evasion or avoidance within the meaning of Article 27(1) of the Sixth Directive 77/388, as amended by Directive 2005/92."

In February 2008, Poland drafted the following amendments to its VAT Act:

The provisions regarding the security deposit of PLN 250,000 would be abolished, however they would be replaced by new provisions stipulating that the extension to 180 days of the repayment of excess VAT would be still be applicable to businesses that have been trading for less than 12 months, unless a guarantee is lodged. The difference between the guarantee and the security deposit being that the guarantee would be for an amount equal to the excess VAT to be repaid. Also, the guarantee could be released after 6 months from the date of filing the declaration in which the excess VAT occurred, compared to the 12 –month –time limit currently in force.



C-288/07 Off-street car parking

Local authorities in the UK were paying VAT on off-street parking until the decision in case C-446/98, Fazenda Pública, in which the European Court of Justice held that the provision of off-street parking by a public body was not necessarily subject to VAT. Following this decision, UK local authorities made claims for repayment of VAT on off-street parking they had previously paid. The UK tax authorities, HMRC, refused to pay these claims however.

The local authorities took HMRC to the UK VAT Tribunal claiming that they did not have to pay VAT because they were not in competition with the private sector in respect to the provision of off-street parking.

The local authorities asserted that the question of the exemption from VAT for public bodies must be dealt with separately for each of the local authorities in question. The tribunal considered each council separately to determine whether exemption from VAT would lead to a distortion of competition and ruled in favour of the local authorities. However, HMRC appealed the decision to the High Court, which stayed the proceedings and made reference to the ECJ for a preliminary ruling.

The ECJ has confirmed HMRC's view that competition must be evaluated by reference to the activity in question and not by reference to any particular local market. The ECJ also ruled that the word "significant" in the concept of "significant distortions of competition" meant something which must be more than negligible, in contrary to the council's view that "significant" should mean a "materially adverse effect" or "exceptional effect" on the public sector body's competitors. The ECJ further held that the competition in question included potential and actual competition as well "provided that the possibility of a private operator entering the relevant market is real, and not purely hypothetical".

The ECJ's decision appears to back HMRC, however, it is now for the High Court to come to a final decision.

Although the ECJ considered the provision of off-street parking only, the decision may have an impact on the VAT treatment of many other council services as well.



meridian



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