
Tax Planning International Indirect Taxes
2013
03/31/2013
Articles

11 IDTX 14

A discussion of global VAT hot topics: A Swiss perspective

Michaela Merz and Verena Gritsch-Meier PwC in Switzerland

I. Introduction

The second workshop of PwC Switzerland's International VAT Forum was held on November 6, 2012 with discussions centring on international VAT hot topics. Several interesting matters were discussed during the workshop, including the EU Commission's quick reaction mechanism¹ proposal to tackle VAT fraud effectively, as well as the current situation in terms of VAT refunds in Italy. However, the main focus was on the perceived change in approach of various EU tax administrations with regard to the definition of "permanent establishment" for VAT purposes. As this can fundamentally change the VAT treatment of transactions and create VAT exposure, businesses should pay close attention to these developments.

¹ Proposal for a COUNCIL DIRECTIVE amending Directive 2006/112/EC on the common system of value added tax as regards a quick reaction mechanism against VAT fraud (published July 31, 2012).

II. The EU Commission's quick reaction mechanism proposal

The "Green Paper on the future of VAT – Towards a simpler, more robust and efficient VAT system"² indicated that decreasing VAT revenue is not only attributable to tax avoidance and losses due to insolvencies, but also to specific forms of fraud, in particular to the so-called carousel and missing trader frauds. These sophisticated schemes involve not only goods but also services; they emerge quickly and on an international scale often have a significantly negative impact on public finances. By way of example, the fraudulent transactions in connection with the recent greenhouse gas emission allowance trade resulted in a VAT loss of more than €5 billion in just 18 months, according to the European Union.

² Published by the European Commission on December 1, 2010 followed by a public consultation until May 31, 2011.

For this reason the EU Commission published a proposal at the end of July to establish a quick reaction mechanism (QRM) that provides EU member states legal grounds for taking immediate measures to combat fraud schemes. In line with the currently applicable EU legislation, the only option for member states to vary from the VAT rules is to apply for a "derogation to the rules". This is a time-consuming procedure which can take several months, requires the agreement of all member states and is therefore not efficient in a sudden fraud situation.

The QRM would also provide a pre-defined list of anti-fraud measures for the use of member states. The flexible procedural rules would enable a case-by-case assessment of whether it is necessary to take the measures without a unanimous decision requirement and it can be deployed within a month. As per the proposal the only pre-defined anti-fraud measure at the moment is the application of the reverse charge mechanism for fraudulent transactions, which makes the recipient of the goods/services liable for VAT. This provides a higher degree of control to the member states and can decrease the VAT loss in such situations.

Once this measure is adopted, it will mean that businesses trading throughout the European Union need to be aware that member states can quickly change their legislation and that the respective changes would have to be implemented on short notice in ERP systems. Businesses in certain

industries e.g. construction or telecommunications, will need to be on constant alert for any such changes to VAT.

III. VAT refund situation in Italy

In Italy, established and non-established entities appear to be treated differently in connection with the recovery of input VAT.

If a non-established entity applies for a VAT refund via its Italian VAT return, it is also required to submit a bank guarantee covering the full amount of the VAT refund claim in order to speed the recovery period. The guarantee must be maintained for three years. However, established entities are not required to submit such a guarantee.

In Italy, established and non-established entities appear to be treated differently in connection with the recovery of input VAT

This differing treatment of established and non-established entities leads to an economic disadvantage for foreign businesses that conduct transactions in Italy. By the same token, a competitive advantage arises for

companies domiciled in Italy. The cost of the bank guarantee can be a very substantial amount that could result in creating a burden for conducting business in Italy, especially when combined with the administrative work involved.

The remedy for non-established business finding themselves in this situation would be to initiate an infringement procedure.

IV. Unusual interpretation of "permanent establishments" in Spain, Poland and Hungary

In Europe, it appears that VAT authorities are more frequently challenging the business structures of VAT-registered entities and coming to the conclusion that the company has a "permanent establishment" for VAT purposes.

A. Spain

The Spanish tax authority has over the years changed its interpretation as to what constitutes a permanent establishment ("p/e") for VAT purposes. Prior to 2010 the Spanish tax authority took the view that the mere rental of a warehouse in Spain was sufficient to create a "VAT-only p/e" in the country. This, coupled with the implemented "force of attraction" rules, led to a situation in which all sales made of the stocks held in Spain were automatically attributed to the deemed p/e, even if it had no physical presence (other than the stock) in Spain.

As a result, non-established businesses could no longer apply the reverse-charge VAT treatment to their domestic sale of goods, but instead were required to register for and charge Spanish VAT on such supplies. This enabled businesses to use the input VAT credit (if any) more effectively and thereby enhance their cash-flow position in Spain.

However, in early 2010 the Spanish tax authority changed the country's VAT legislation, revised their view and applied a different interpretation. While a rented warehouse was still seen as a p/e for VAT purposes, additional facts were also taken into account. These included:

- a minimum degree of stability and permanence in time;
- sufficient structure to supply services independently;
- permanent presence of both human and technical resources to make these supplies.

Clearly, this interpretation was more in line with established case law of the European Court of Justice (ECJ), given that – as a result of another public consultation in 2010 – the aforementioned force of attraction rules were also disregarded if non-established businesses merely rented warehouse space in Spain. Thus such businesses were allowed to apply the reverse charge treatment to their supplies, even if they rented warehouse space in Spain.

The Spanish tax authority published four more public consultations on this topic during 2011. The result was that their interpretation of p/e for VAT purposes reverted to the position taken in 2009, meaning the mere rental of warehouse space in Spain without any further presence in the country creates a VAT p/e, which is automatically involved in all sales of goods in Spain. Therefore, non-established businesses should register for VAT purposes and charge Spanish VAT on their local supplies.

Apparently, if a non-established business only rents a warehouse and has no other presence in Spain, then it does not meet the p/e requirements as established in ECJ case law and defined in

the implementing VAT regulation.³ This would provide sufficient legal grounds for non-established companies to apply the reverse charge treatment to their supplies and successfully defend their position in court (if required). However, if for whatever reason a Spanish VAT registration is more beneficial for a non-established company, it would be possible to apply for it using the arguments of the 2011 public consultations as justification.

³ Council Implementing Regulation (EU) No 282/2011 of March 15, 2011 laying down the implementing measures for Directive 2006/112/EC on the common system of value added tax.

For completeness, we note that in the event that the non-established company does not rent but rather owns a warehouse in Spain, the p/e situation should be the same. However, this may give the tax authority additional leverage to argue that a VAT p/e exists. Moreover, in this case, in the event that a VAT p/e does exist it may only be one more step for the tax administration to challenge a p/e for direct tax purposes.

B. Poland and Hungary

Spain however is not the only jurisdiction where businesses may face VAT p/e issues. By way of example, experience with recent Polish VAT audits shows that tax authorities may imply a VAT p/e status to non-established entities that have e.g. a toll manufacturing contract with a resident company. In such cases the tax authorities investigate in greater depth whether additional functions were added to the originally agreed tolling contract. In the event that over the years the toller becomes more involved and starts to provide extra services such as warehousing, distribution of goods, etc., or if some of the principal's personnel has been delegated to the toller's site, the tax authorities may claim that the non-established Principal has in fact established a p/e in the country.

Recent experience also shows that the Hungarian tax authorities seem to apply a somewhat similar approach. However, it appears that the Hungarian authorities have not yet formalised their position on this topic yet.

V. Participant experience

Our workshop participants have recently experienced that the European VAT authorities tend to make many more checks as to whether a permanent establishment may have been created due to the business activities carried out in the country. Businesses have to be aware that, with a VAT registration, the tax authorities can start asking questions and that this initial phase of inquiry is crucial. If misleading information is provided, which in our experience can happen quite quickly, the case may end up in court and may be quite demanding to defend once the authorities have come up with an opinion and made direct tax claims, in addition to any VAT that would become due e.g. in countries where the reverse-charge mechanism is applicable.

For More Information

The World Wide VAT international VAT forum at PwC Switzerland was launched three years ago as a platform where participants have the opportunity of meeting and speaking with international business people who are also dealing with indirect taxes. World Wide VAT is meant to be a platform for discussing the latest global indirect tax topics and sharing experiences. At each session, we focus on specific topics but also include further hot international VAT topics if they come up.

The workshops take place at PwC Zurich. International guests may participate via Live Meeting. For details please click here :

https://www.pwc.ch/user_content/editor/files/events12/pwc

Michaela Merz is a partner in the VAT department of PwC in Zurich/Switzerland. She may be contacted by e-mail at michaela.merz@ch.pwc.com

Verena Gritsch-Meier is a senior manager in the VAT department of PwC in Zurich/Switzerland. She may be contacted by e-mail at verena.gritsch@ch.pwc.com

Copyright © 2013, The Bureau of National Affairs, Inc. Reproduction or redistribution, in whole or in part, and in any form, without express written permission, is prohibited except as permitted by the BNA Copyright Policy. <http://www.bna.com/corp/index.html#V>