CFE's Tax Top 5

Key tax news of the week

Brussels, 9 October 2017

1. EU Commission propose comprehensive reform of EU VAT rules

Following up on the VAT Action Plan of April 2016, the European Commission published a comprehensive proposal aimed at adopting a definitive VAT system for intra-EU cross border trade based on the "destination principle", i.e. taxation in the Member State of destination of the goods. The definitive VAT system shall replace the transitional VAT system of 1993, which is no longer fit for purpose in today's more dynamic and highly digitalised economy. In its present form of operation, the VAT system is fragmented, susceptible to fraud and disrupts the cross-border operations of digital businesses and SMEs.

Destination principle/ One-stop-shop

The change to a destination-principled VAT system will substantially impact all businesses trading in the EU Single Market. The Commission have now proposed the first step in implementing the definitive VAT system. Under a destination-based VAT system, the supplier shall be liable for VAT at a rate applicable in the Member state of destination. Goods traded cross-border will be taxed in the country where they are consumed (the destination country) and at the destination country's tax rate, rather than where they are produced (the origin country). Under the proposal, the supplier will be obliged to account for VAT at the rate applicable in the destination Member State.

The suppliers will not be required to register in the destination Member State for purposes of VAT, but can avail of the 'one-stop-shop' digital portal. By means of the 'one-stop-shop' portal businesses will be able to file declarations and declare VAT on cross-border transactions in a single return and the same rules and the language of their state of establishment. Member states will accordingly settle their VAT that is due directly.

Cross- border B2B transactions

Under the current rules, B2B cross-border supply of goods is exempt from VAT, in the sense that the transaction is split between an exempt intra-EU supply of goods in the Member state of origin, and, a taxable intra-EU acquisition in the Member state of destination. This design of the VAT system amounted to substantial revenue losses, with the VAT gap estimated at *cca* 50 billion per year. The Commission thus propose introduction of a single taxable supply in the member state of destination.

Certified taxable person

The Commission propose a new Council regulation for a certified taxable person. This is one of the steps towards a full destination based VAT system. Under this concept, certain simplification rules, which could be fraud-sensitive, will apply only where a certified taxable person is involved in the relevant transaction. In this sense, only where a business is certified, it could apply the EU reverse charge mechanism on intra-EU supplies. On basis of this concept, no fraud should occur as a result of VAT not being charged on intra-Union supplies made for a certified taxable person, as the certified taxable person by definition is a reliable taxpayer. A Council Implementing Regulation will need to be adopted on basis of Article 397 of the VAT Directive to ensure that the authorisation procedure for certified taxable person status is sufficiently harmonised throughout the EU.

Quick fixes

On basis of a Council mandate to introduce certain ‘quick fixes’, the Commission is proposing the following three quick reforms: simplification and harmonisation of rules regarding call-off stock arrangement; recognition of the VAT identification number of the customer as a substantive condition in order to exempt from VAT an intra-Community supply of goods; and simplification of rules in order to ensure legal certainty regarding chain transactions. This proposal introduces additional, fourth ‘quick fix’ required by the Council, namely, the harmonisation and simplification of rules on the proof of the intra-Community transport of the goods in order to be exempt from VAT an intra-Community supply of goods. This simplification would also be available for certified taxable persons only. The "quick fixes" shall only be available to certified taxable persons, except for the VAT number quick fix which cannot be restrictive.

Timeline

A modernisation of the existing VAT system shall be made operational in phases:

a) A legislative package on the definitive VAT system for intra-Union business-to-business (B2B) trade (the 'definitive VAT system'), proposed on 4 October 2017;

b) A proposal on the reform of the VAT rates (forthcoming in 2017);

c) A proposal to reinforce the existing instruments for VAT Administrative Cooperation (forthcoming in 2017);

d) A proposal to simplify the VAT rules for SMEs (forthcoming in 2017).

The first part of the Commission proposal (under “a”) is at the agenda of tomorrow’s ECOFIN Council meeting. The Council shall discuss the 4 October 2017 Commission proposal on the definitive VAT system (the destination principle and introduction of one-stop-shop), a proposal for Council regulation on certified taxable persons, proposal for Council implementing regulation regarding certain exemptions, the proposal on the follow-up VAT action plan.

The three other aspects (under “b”, “c” and “d”) are yet to be proposed by the end of 2017. This plan will be followed by a comprehensive VAT Directive forthcoming in 2018, which sets the detailed technical guidance for operation of the definitive VAT system.

2. ECOFIN 10 October Council of EU meeting in Luxembourg

The Council of the European Union sitting as ECOFIN shall meet on 10 October in Luxembourg. EU finance ministers are expected to approve the new system for resolving of double taxation disputes. The directive aims to strengthen dispute resolution on double taxation between member states that arise from the interpretation of double tax treaties. Agreement on the directive was reached at the Council's meeting on 23 May 2017. As with all tax files, Council requires unanimity (all member states must agree) to adopt the directive under Article 115 of the Treaty on the Functioning of the European Union. Directives then require further national implementation into domestic legislation.

Council is also expected to adopt conclusions on the financing aspects of climate change, ahead of a UN conference in November 2017. Under ‘other business’ Council will discuss Commission’s proposed VAT reform and the proposed strategy for digital taxation, aimed at closing off loopholes that leave digital companies’ largely untaxed.

3. *Amazon* State aid ruling issued and Ireland referred to Court concerning *Apple*

Continuing their investigation into potential corporate tax ‘sweetheart deals’ with EU governments, the EU Commission’s competition enforcement arm, DG Competition adopted a decision establishing a tax liability for Amazon in Luxembourg of €250 million on basis of the EU State Aid rules. The Commission also initiated an enforcement action at the European Court of Justice against Ireland for failure to comply with a Commission decision on recovery of assessed back taxes from Apple’s Irish entities amounting to €13 billion.

Commission's Amazon State aid inquiry focused on a tax ruling issued to Amazon in 2003 and extended in 2011. Commission claim that this ruling endorsed a method of calculation of annual payments from the operating company to the holding company for the rights to the Amazon intellectual property, which exceeded, on average, 90% of the operating company's operating profits. Commission say that the profits were significantly higher than what the holding company was due to pay to Amazon US under the terms of the cost-sharing agreement.

Under Luxembourg's tax law, the operating entity is subject to corporate tax whilst the holding company is not due to the chosen legal form - a limited partnership with US partners. The taxation rights to the partners’ profits thus belong to the United States, with the US tax liability being consistently deferred. Under the tax ruling, the holding company was a shell company that passed on intellectual property rights to the operating company. The Commission further claim that the holding company was not actively involved in the development the IP and did not perform any activities that would justify the level of royalty it received. In this way, three quarters of Amazon's profits were unduly attributed to the holding company, where they remained untaxed. This tax structure was endorsed by a tax ruling issued by the Luxembourg government, which amounted to selective advantage for Amazon. The Commission does not challenge the structure itself, rather the tax ruling that endorsed artificial methods for taxation of profits that amounted to selective advantage for Amazon. Such advantage was not available for other companies which are in a comparable factual and legal situation, an illegal practice under the State aid rules.

Commission have set out the methodology to calculate the back taxes initially estimated at €250 million, plus interest. An action for annulment of a Commission State aid decision does not have a suspensory effect, thus the Luxembourg government is obliged to recover the assessed tax. Under EU law, assessed back taxes under State air rules are not a penalty, rather an assessment that levels the playing field, and does not penalise the operating company beneficiary of the State aid.

Currently DG Competition is looking into the more tax rulings from Luxembourg, as regards the corporate tax treatment of McDonald's and GDF Suez (now Engie).

4. Germany and Hungary requested to align national VAT rules with EU law

The Commission sent a letter of notice to Germany and Hungary for breach of EU rules on VAT refunds. Under national rules, a taxable person established in Germany applying for a VAT refund from another Member State using a German web portal can lose the right to a refund. In the case of Hungary, companies are obliged to provide the Hungarian tax authorities with detailed information for VAT purposes on certain business-owned transport that use public roads. This requirement infringes the VAT Directive as it primarily affects cross-border EU transactions and introduces administrative formalities connected with the crossing of borders. The Commission may send a reasoned opinion to the German and Hungarian authorities if they do not comply with the letters of formal notice.

5. Belgium's national taxation rules on bonds' interest income in breach of free movement of capital

As part of the October infringements package, the Commission sent a reasoned opinion to Belgium on the taxation of interest income from bonds for infringing EU law under Article 63 of the TFEU and Article 40 of the EEA Agreement. Belgium accords a different treatment of interests depending on the origin of the bonds, allegedly treating interest from Belgian Bonds more favourably. Such a difference in the treatment of interest income amounts to an obstacle to the cross-border freedom of movement of capital, which is in breach of Article 63 TFEU and Article 40 of the EEA.

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