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# ***Financial Services VAT Alert***

## **Tracking EU VAT Developments**

*Edition 2011/7&8*



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## Editorial

Dear readers,

Over the past months the Court of Justice of the European Union has been particularly assailed by requests on important and interesting questions for the financial sector. While the draft directive on the treatment of financial and insurance services seems to stagnate - even though the Polish Presidency did not count its efforts - Member States keep on interpreting the existing rules. In this edition, you will find a selection of news relevant for financial institutions, which remind us that VAT and financial services definitely remain a particular combination.

Enjoy reading!

*Chantal Braquet (Editor)*

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## **EUROPEAN UNION**

### **1. ECJ rules that the purchase of non-performing loans is outside the scope of VAT: GFKL (C-93/10)**

*Taxpayers purchasing non-performing loans and who currently treat these supplies as VAT taxable should reconsider their position*

On 27 October 2011, the European Court (“ECJ”) delivered its judgment in case C-93/10 GFKL Financial Services AG. (please see our FS VAT Alert of March 2010).

The ECJ followed the Advocate General Jääskinen’s preferred reasoning and conclusion in this case. The ECJ ruled that GFKL did not supply a service against consideration when purchasing a portfolio of distressed debt from a bank.

Firstly, the ECJ observed that there was no specific agreed commission paid by GFKL to the Bank, contrary to the situation in the MKG case (C-305/01).

Furthermore, the ECJ admitted the existence of a difference between the nominal value and the purchase price of the non-performing receivables. However, the Court took the view that this difference does not represent the consideration for a supply of a service, but is a reflection of the actual economic value of the debts at the time of their assignment, which results from the fact that they are doubtful and from the increased risk of default of the debtors.

The main consequence of the judgement is that no VAT should apply on the acquisition of portfolio of defaulted debts acquired at a discounted price to the extent that no consideration for a service is paid.

The judgement should reduce the lack of legal certainty arising from the heterogeneous interpretation of the treatment of these transactions amongst the EU triggered mainly by the specific facts and outcome from the MKG case. assume a taxable supply.

*Sylvia Neubert*  
*+49 69 9585 6235*  
*sylvia.neubert@de.pwc.com*

## **2. Commission supports VAT deduction for costs invoiced to individual partners (C-280/10)**

Questions have been referred to the ECJ by Poland concerning the question whether input VAT incurred before formal registration of a partnership, and before the partnership becomes VAT registered, can be recovered by the partnership, if such VAT relates to the taxable activities of the partnership but was invoiced before the partnership existed. Based on an unofficial translation of the report for hearing, it is understood that the Commission has submitted that the partnership should be permitted deduction provided that, viewed objectively, the costs were incurred with the intention that they would be used by the partnership in making taxable supplies.

*Danny M. Cambell*  
*+44 (0) 20 721 34165*  
*danny.m.campbell@uk.pwc.com*

## **3. ECJ rules SWIFT messaging services liable to VAT: Nordea Pankki Suomi Oyj (C-350/10)**

*This judgment creates a greater VAT cost for financial institutions established in EU Member States, which consider these services as exempt from VAT*

On 27 July 2011 the ECJ, without an Advocate-General's opinion, delivered its judgment regarding the question whether SWIFT services used in payment transactions and securities transaction settlements between financial institutions are exempt from VAT.

The ECJ began by reiterating that to be treated as VAT exempt transactions concerning transfers between accounts and transactions in securities, the services provided must have the effect of transferring funds and entail changes of a legal and financial character and must be more than a data-handling system. The transfer transaction is effected when the legal and financial relationship between the parties is actually changed rather than the action which causes the funds to be transferred.

Services of third parties acting between the parties to a transaction could fall within the exemption, but they must effect the actual change in the legal and financial relationship by the transfer of funds or of securities.

The taxpayer had argued that the services did change the legal and financial situation. They were essential to the transfer of funds, and registration of the transfer of securities was essential in order to protect the interests of the parties, even though ownership of the securities was actually transferred earlier, when the securities were traded on the stock market.

The ECJ pointed out that SWIFT was only responsible for the secure transmission of the messages and did not have access to the information contained in them. The transactions could only be effected by the financial institutions themselves acting on the basis of the information transmitted via the SWIFT system, and the exemption does not need to extend to each individual process necessary for the activity itself to take place. The ECJ therefore judged that SWIFT services did not fall within the scope of the exemption.

Financial institutions, which currently treat SWIFT services as VAT exempt will need to change their practice and evaluate the level of risk for the past if such services were treated as exempt from VAT.

#### **4. EU Commission refers Denmark to the ECJ for allowing non-taxable persons to join VAT groups (C-95/11)**

In earlier FS VAT Alerts, we reported on the infringement proceedings initiated by the EU Commission against a number of EU Member States for allowing non-taxable persons to join VAT groups. The EU Commission has now also initiated such proceedings against Denmark. The remaining Member States are Finland and Spain. It remains to be seen whether these

Member States will amend their VAT rules within due time. Otherwise, it will only be a matter of time before such proceedings will be initiated against them.

*Chantal Braquet*  
*+352 49 48 48 4146*  
*chantal.braquet@lu.pwc.com*

#### **5. Input VAT recovery ratio – Towards a worldwide “pro-rata”? (C-388/11)**

*This request for a preliminary ruling impacts the VAT recovery of taxpayers operating via branch structures*

On 11 July 2011, the Conseil d'Etat filed a request for a preliminary ruling concerning the VAT recovery position for an entity established in several EU and non-EU countries. The questions raised at the level of the Conseil d'Etat concern mainly which turnover may be taken into account for the VAT recovery computation and how this turnover should be taken into account in the calculation of the VAT pro-rata of the head office.

The Conseil d'Etat therefore asked the ECJ whether:

1. the whole EU turnover has to be taken into account to determine the VAT recovery position of the head-office and each of the branches;
2. the same solution should apply for branches established outside of the EU, particularly in the light of the right of deduction resulting from banking and financial transactions effected with non-EU clients;
3. the answer to the questions 1) and 2) may vary between the Member States due to the option left to the latter

particularly in respect of setting up business sectors.

4. If the answers to questions 1) and 2) above are positive,
  - whether the global pro-rata should apply restrictively to expenses incurred by the head-office for its branches;
  - whether the foreign turnover should be taken into account in accordance with the rules of the countries of establishment of the head-office and of the branch.

In France, aside VAT, the outcome of this case will also have a significant impact on the calculation of the amount of payroll tax (“taxe sur les salaires”) payable. Taxe sur les Salaires applies on salaries paid to employees and is applied at a progressive rate (average is around 10-13%) for companies that do not recover input VAT (VAT exempt sectors mainly). The amount of the tax due is inversely proportional to the VAT pro-rata and increases depending on the percentage of operations that do not give rise to the right to recover input VAT.

Considering the possible impact on the decision on their financial position, we recommend that cross-border established VAT-exempt businesses already assess their practices and positions as Member States do currently take divergent views on the computation of the VAT recovery ratio in such situations.

*Ivan Féron*  
*+33 (0) 1 56 57 42 89*  
*ivan.feron@fr.landwellglobal.com*

## **6. Preliminary questions referred to the ECJ in pension fund management case (C-424/11)**

In February 2011, the First Tier Tribunal (“FTT”) referred questions to the ECJ on the VAT treatment of investment management services supplied to pension funds (please see our FS VAT Alert of February 2011).

Capital International Limited (“CIL”) provides investment management services to Wheels Common Investment Fund Trustees et al. (“Wheels et al.”). CIL invoices these pension funds including VAT and pays this VAT to the British Tax Authorities. The question is whether VAT was correctly applied to the service of CIL.

The challenge to the UK’s VAT treatment of investment management services follows the ECJ’s decision in JP Morgan Fleming Claverhouse Investment Trust plc (C-363/05) on the scope of the VAT exemption for the management of “special investment funds”.

It is not in dispute that the services of CIL by nature are qualify as management services as described in Article 135 (1) (g) of the VAT Directive. The issue in this case is whether Wheels et al. qualify as “special investment funds”.

By its first question, the FTT sets out the characteristics of a pension fund and asks whether such an organisation falls within the scope of the VAT exemption for the management of special investment funds.

The second question addresses, by reference to the principles of fiscal neutrality and the circumstances set out under the first question, whether:

- Member States are entitled to exclude funds as defined in the first question from the exemption, even when collective investment undertakings defined in Directive 85/611 are included;

- the criteria listed in question 1 can be used to identify those funds which are excluded; and
- it is relevant that funds are “similar to and in competition with” organisations recognised as “special investment schemes”.

The third question asks if the similarity to “special investment funds” must be considered separately from the extent of competition with them.

**The attached Bulletin provides more details and analysis on this.**

*Christine O'Malley*  
*+44 (0)161 245 2429*  
*christine.o'malley@uk.pwc.com*

## **7. Preliminary question to the ECJ regarding the meaning of tax evasion and the concept of “absence of actual supply” (C-285/11)**

*This question is raised in a case involving the supply of goods but could give some interesting information on what is covered by the term “tax evasion”.*

In a rather long reference, a Bulgarian Court referred to the ECJ some interesting questions on exercising the VAT deduction right in the frame of chain supplies of goods affected by tax evasion.

The case appears to involve transactions with goods, which were properly documented and declared for VAT purposes by the supplier, in respect of which the customer has in fact acquired the right of ownership of the goods invoiced and there are no indications as to whether he actually received the goods, which were meant to be

delivered by another person than the supplier (issuer of the invoice).

In brief, the questions addressed to the ECJ basically approach the following matters:

- The relation between the concepts of “absence of actual supply” and “tax evasion”; moreover, the Bulgarian court asked the ECJ what the latter concept actually covers.
- Whether the VAT recovery right should be considered not only in the frame of the transaction on which such VAT was charged, but also taking into account preceding and subsequent transactions (including also the case whereby exercising such right in the hands of the customer is dependent on the conduct of the supplier).
- Whether the transaction under discussion should be regarded as economic activity within the VAT sphere.
- The extent to which the authorities may restrict by means of legislation or practice/jurisprudence the exercising of the VAT deduction right.

## **8. Preliminary questions on the application of the open market value on supplies between connected parties (C-298/11)**

*The Administrativen sad Varna (Bulgaria) has referred questions to the ECJ*

In a nutshell, the questions raised are whether:

1. for transactions between related parties, where the consideration for the supply is lower than the open market value, the latter only constitutes the taxable basis if the recipient is not entitled to full input VAT recovery.

2. Article 80(1)(a) and (b) of the VAT Directive is to be interpreted as meaning that, if the supplier has exercised the right to deduct in full the input tax on goods and services which are the subject of subsequent supplies between connected persons at a value lower than the open market value, and that right to deduct input tax has not been corrected under and the supply is not subject to a tax exemption, a Member State is not permitted to adopt measures whereby the taxable amount is exclusively the open market value?
3. Article 80(1)(a) and (b) of the VAT Directive is to be interpreted as meaning that, if the recipient has exercised the right to deduct in full the input tax on goods and services which are the subject of subsequent supplies between connected persons with a lower value than the open market value, and that right to deduct input tax has not been corrected, a Member State is not permitted to adopt measures whereby the taxable amount is exclusively the open market value?
4. the cases listed in Article 80 of the VAT Directive constitutes an exhaustive list of cases representing the circumstances in which a Member State is permitted to take measures to correct the taxable amount?
5. a provision of national law such as Article 27(3)(1) of the Zakon za danak varhu dobavenata stoynost (Law on VAT) is permissible in cases other than those listed in Article 80(1)(a), (b) and (c) of the VAT Directiv?
6. Article 80(1)(a) and (b) of the VAT Directive has direct effect in a case like the present, and whether the domestic court may apply it directly?

## **9. Taxation of the financial sector**

On 15 June 2011, the EESC gave its Opinion on the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on Taxation of the Financial Sector.

Key points are as follows:

- Appropriate regulation and supervision should ensure the stability and effectiveness of the financial sector as well as the creation of appropriate incentives for financial sector institutions.
- The financial sector should contribute to fiscal consolidation efforts in a fair and substantial way.
- The tax base for such fiscal mechanisms should be harmonised and double taxation relief measures should be coordinated. Initiatives should take into account the divergent impacts they may have on each individual Member State.
- Any new tax on financial institutions should be designed in a way that takes into account the institutions' ability to pay and their ability to comply with new capital requirements. It is also vital to take into consideration all aspects of competitive implications of new taxes on the banking industry.
- As regards the administrative burden in relation to the new tax, the Commission should pay particular attention to the proportionality principle.
- The EESC believes that if a new financial sector tax were based on cash flows or based on similar factors, then the Commission should assess the merits of designing it within the VAT framework.

## **10. Commission proposes Financial Transaction Tax (FTT)**

Following an initial announcement in June of this year, the European Commission has released detailed proposals for the introduction of a financial transaction tax (FTT), which would be levied on transactions between financial institutions when at least one party to the transaction is located in the EU. The rate of FTT would be fixed by each Member State - subject to a minimum rate of 0.1% for financial transactions other than derivatives and 0.01% for derivatives. The proposed start date for the new tax is 1 January 2014. The Commission also intends to explore ways to introduce the FTT at a global level through the G-20.

The FTT would be levied on financial transactions taking place between financial institutions when at least one party to the transaction is located in the EU. The definition of 'financial institution' is broad and includes investment firms, organised markets, credit institutions, insurance and re-insurance institutions, collective investment schemes and their managers, pension funds and their managers, holding companies, leasing companies and special purpose vehicles. Transactions involving other businesses and private individuals, including mortgages, bank loans, insurance contracts etc, would be outside the scope of the new tax.

The Commission estimates that the FTT could raise approximately Euro 57 billion per annum, with Member States having discretion to increase 'own resource' revenues by taxing transactions at a higher rate.

In proposing the new tax, the Commission highlights the support received by the financial sector from governments following the financial crisis and the apparent tax advantage enjoyed by the sector as a result of the VAT exemption for financial services. The proposal will now be discussed by the Council of Ministers.

### **DID YOU KNOW? AUSTRIA**

#### **Proposed changes to reverse charge accounting from 1 January 2012**

The Government recently published a Bill of the Austrian Tax Amendment Act, which provides amongst others for an exception to the reverse charge system in respect of admission fees for trade fairs, exhibitions, seminars, etc. held in Austria and organised by a non-Austrian supplier. If the new Bill is adopted, the VAT liability of admission fees for such transactions effected after 31 December 2011 will remain with the supplier.

*Christoph Wagner*  
*+43 1 501 88 36 41*  
*christoph.wagner@at.pwc.com*

## **DENMARK**

### **11. National Tax Tribunal refused input VAT recovery on consultancy costs related to the sale of all shares in a 100 % owned subsidiary**

This is the first case after the ECJ case AB SKF where the National Tax Tribunal ("NTT") considered that the consultancy costs related to the sale of the shares were linked to the VAT exempt sale of shares and could therefore not qualify as overhead costs. Therefore the company was not entitled to recover input VAT incurred on these costs. The NTT noted that the company was a holding company with only 2 employees whose sole VAT taxable activities were the supply of administration services to the subsidiaries. Also, the NTT did not consider the sale as a TOGC and referred to the judgment of the ECJ in the case AB SKF.

We believe that the NTT interpreted the ECJ's judgment in AB SKF restrictively as it did not mention that the related costs were a component of the price of the shares. Instead, the NTT argued that the costs were not a component of the price for the VAT taxable administration services and therefore not related to the VAT taxable activity. In our view a sale of 100 % of the

shares in a company should be considered as a TOGC and therefore entitle for VAT recovery.

### **12. Binding ruling in relation to VAT exemption on "sub intermediation"**

A binding ruling from the Tax Board concluded that the VAT exemption in relation to negotiation of credit also covers the situation where a company concludes a credit intermediation contract with a provider of financing and according to which the intermediation company is allowed to use subagents who will have the direct contact with the relevant debtors.

The Tax Board considered that the intermediation company as well as the subagents, supplied negotiation services which were distinct in character and were specific to and essential for the exempt transaction. The commission received by the intermediary company was therefore VAT exempt even though the company did not have direct contact with the debtors. The Tax Board referred to the ECJ Case Volker Ludwig.

*Anette Henriksen*  
*+45 3945 3903*  
*ath@pwc.dk*

**DID YOU KNOW?  
CZECH REPUBLIC**

**Proposal for the 2012 amendment of  
the VAT act**

The Chamber of Deputies has approved the Amendment to the Czech VAT Act regarding the changes of VAT rates. The Amendment should subsequently be discussed at the Senate. According to the Amendment, the changes of VAT rates should be as follows:

- Increase in the reduced VAT rate from 10% to 14% with effect from 1 January 2012;
- Unify the VAT rate at 17,5% with effect from 1 January 2013 (the standard rate is currently 20%).

*Martina Kudlacova*  
+420 251 152 565  
[martina.kudlacova@cz.pwc.com](mailto:martina.kudlacova@cz.pwc.com)

## **GERMANY**

### **13. Clarification of place of supply of services to consumers**

*Guidelines from the German Ministry of  
Finance regarding the VAT status of a  
customer and the means of proof – affects  
all tax payers*

The Ministry of Finance has amended the VAT Implementation Decree with effect from 1 July 2011 following the release of Council Regulation 282/2011 on 15 March 2011, which provides necessary clarification on the place of supply of services to consumers.

The more important clarifications for financial services providers are:

- Classification of a customer as consumer or business is to be based on the circumstances at the time of supply.
- If there is doubt on whether the business service is for the head office, or for one or more branches of the customer, the fall-back position is the head office. However, the supplier must carefully consider all the circumstances – including the VAT ID No. given by the customer – before coming to the conclusion that the doubt cannot be resolved.
- A supplier may assume that a customer has acquired the service for his business where the latter has provided him with a VAT ID No. which he has verified through the Central Tax Office.
- If the business customer has applied for, but not yet received, a VAT ID No. the supplier may use his discretion in satisfying himself as to the business context of the transaction. However, any such satisfaction is only temporary. In the final analysis, the VAT ID No. must be furnished – at the latest by the time of the lower tax court hearing of the case – if the supply is not to be ranked as private.
- If the supplier is unable to obtain a certificate of the business identity of his non-EU customer from that customer's home country tax authorities, he has discretion on the form of evidence that he may accept.

#### **14. VAT Implementation Decree amended following the Swiss Re ruling**

*VAT Implementation Decree amended to consider all transfers of intangibles as services for VAT*

The Ministry of Finance has supported the ECJ ruling Swiss Re by amending the VAT Implementation Decree ordaining that all transfers of intangibles are to be regarded as services for VAT.

In October 2009, the ECJ held that the transfer of life assurance policies between insurance companies was a service for VAT, rather than a delivery of goods (ECJ, C-242/08, Swiss Re). The Ministry of Finance has now followed this judgment with an amendment to the VAT Implementation Decree ordaining that all transfers of intangibles are henceforth to be regarded as services for VAT. The examples it quotes are goodwill, customer lists and life assurance re-insurance contracts. In principle, the new definition is to apply immediately to all cases still open; however, no objection will be taken to treatment of transfers of intangibles up to 30 June 2011 as sales of goods.

*Felix Becker*  
*+49 69 9585 6665*  
*felix.becker@de.pwc.com*

## **GREECE**

#### **15. VAT amnesty until 30 September 2011**

The Government has passed a new law under which taxpayers who have failed to comply with their VAT compliance

obligations may do so by 30 September 2011 on payment of a reduced penalty.

The amnesty will affect the following declarations:

- Periodic VAT returns for the period up to 31 December 2010 (VAT returns for 2011 are outside the scope of the amnesty, thus penalties at 1.5% per month of delay - capped at 60% - will continue to accrue).
- Annual VAT returns.
- Intrastat reports.
- EC Sales and Acquisition Listings.

The reduced penalties are calculated as follows:

- 10% for VAT due up to 31/12/2009.
- 3% for VAT due in 2010.
- If the business pays the tax due in a lump sum, no penalties are calculated.

*Eva Tsika*  
*+30 210 6874506*  
*eva.tsika@gr.pwc.com*

#### **DID YOU KNOW? DENMARK**

##### **Proposal to go towards one VAT recovery pro-rata**

It has been proposed that pro rata VAT recovery and VAT refund for financial transactions to customers outside the EU, which today is calculated as 2 separate percentages, should be based on one VAT recovery percentage and that the calculation should be based on turn over.

*Anette Henriksen*  
*+45 3945 3903*  
*ath@pwc.dk*

**DID YOU KNOW?  
LITHUANIA**

**Latest indirect tax updates**

On 11 July 2011 the Tax Authorities published the supplement to the official Commentary on the VAT Law, which states that in case of termination of a leasing (financial lease) contract of transfer of movable or immovable property, return of such property may be documented in two ways: (1) by issuing a credit note and (2) by issuing an invoice for the property being returned.

*Kristina Krisciunaite*  
+370 5 239 2365  
[kristina.krisciunaite@lt.pwc.com](mailto:kristina.krisciunaite@lt.pwc.com)

## **ITALY**

### **16. Tax assessment period doubled in case of criminal offences – Compliance with the Italian Constitution**

*This decision affects all taxpayers active in Italy and potentially creates a longer period of uncertainty on the amount of VAT due / recoverable*

The Italian legislation provides that the tax assessment period is doubled in case of violations, which give rise to the obligation for a criminal application to be submitted to the competent Authorities because of criminal offences.

The above provision has been challenged by an Italian Second Tier Tax Court, which thought it was not compliant with the so-called “Statuto dei diritti del contribuente”

and the Italian Constitution. In its opinion the concerned law provision extends the tax assessment period (from the ordinary period – i.e. 4 years after the submission of the VAT return - to the longer period – i.e. either 8 years or 10 years depending on whether or not the annual VAT return has been submitted), even in case the ordinary period has ended when the criminal application is submitted to the competent Authorities.

According to the above decision, the Supreme Court has mainly confirmed that the above challenges are groundless and the tax assessment period can be doubled in case there is just the obligation to submit a criminal application.

The above decision has been challenged by major scholars from different perspectives also because it has some important implications for taxpayers, such as:

- uncertainty regarding the actual definitiveness of the tax assessment period;
- necessity to keep the books, registers and other tax/accounting documentations for a longer period (i.e. at least 8 years. Please note that, from an Italian Civil Law perspective, the bookkeeping period is 10 years);
- in case the criminal application was not due in the end, opportunity to consider a civil law action against the Tax Authorities in order to be remunerated as regards the costs borne by the taxpayer.

**17. Automatic cancellation of VAT number when no business activities for 3 years**

*Under Law Decree no. 98/2011, enacted on 15/07/2011, an Italian VAT registration number will be automatically cancelled if a taxable person has not carried out business activities for three years or has not filed VAT returns for the past three years.*

Law Decree no. 98/2011, enacted on 15/07/2011, has changed the Italian VAT Law (Art. 35, Presidential Decree no. 633/1972) as a result of which an Italian VAT registration number will be automatically cancelled by the Italian Tax Authorities in cases where a taxable person has not carried out business or professional activities over the past three years, or has not filed VAT returns over the past three years in cases where it was obliged to do so.

Clarification is awaited in order to understand the meaning of 'not having carried out business or professional activities' (for example, does this mean issuing output invoices and/or receipt of input invoices?).

A taxable person may appeal against a cancellation notice to the competent Tax Courts.

Also under the new Decree, taxpayers who initially fail to notify a VAT deregistration but made a voluntary disclosure by 4 October 2011 may only be subject to a reduced penalty of Euro 129.

**18. Clarification issued by the Italian Tax Authorities - Reverse charge mechanism and obligation to self invoice in case of exempt supply**

Generally speaking, due to the reverse charge mechanism, the VAT obligations related to the supply of goods and the provision of services carried out in Italy by non-resident taxable persons towards taxable persons established in Italy are fulfilled by the taxable person established in Italy. From a practical point of view, the recipient of goods and/or services has to issue a self-invoice and record it in the VAT sales register and VAT purchase register.

The Italian Tax Authorities have recently clarified (guidance no. 37 dated 07/29/2011) that, in case of VAT exempt services without entitlement to input VAT recovery (where the place of supply is Italy), the issuance of the so-called "self-invoice" by the Italian taxable person (VAT registered and established in Italy) - with reference to the services received - is not mandatory if the taxable person would not be required to issue an invoice for the same type of services if rendered by itself (e.g. financial or insurance services).

*Alessia Angela Zanatto  
+39 02 91605728  
[alessia.angela.zanatto@it.pwc.com](mailto:alessia.angela.zanatto@it.pwc.com)*

## LUXEMBOURG

### 19. Luxembourg VAT suspension regime - Law proposal voted on 14th July 2011

The Law proposal for the implementation of VAT suspension regimes has been voted with minor amendments compared to the initial Law proposal dated 24 March 2011 and is applicable as from 1 October 2011. As a reminder, the VAT suspension regime aims at creating a zone or a warehouse within which goods and all linked operations (supply of services, supply of goods, intra-community acquisition of goods and imports) will benefit in principle from a VAT exemption until the goods exit the regime.

The proposal which has been voted and adopted limits the goods which can benefit from the VAT warehouse regime to a restricted list of goods (mainly metals, chemicals in bulk and basic foods products) and further specifies the supervision of this regime.

It should be noted that, it appears to be the intention of the Government to set-up another type of suspension regime, namely a free zone, where normally other rules (notably regarding the type of goods allowed, i.e. high value goods) may apply. This Law proposal should notably be of interest for the investment funds dealing with the goods listed.

*Chantal Braquet*  
*+352 49 48 48 4146*  
*chantal.braquet@lu.pwc.com*

### DID YOU KNOW? HUNGARY

The National Tax and Customs Authority (NAV) has published its key areas of focus for tax audits in 2011. The areas of concern to the NAV include discrepancies between VAT returns and income tax returns and VIES differences concerning IC listings.

In addition to reviewing whether the amount of VAT was correctly determined, the NAV will also a.o. focus on the following VAT related areas:

- In the case of transactions where the parties have agreed on deferred payment terms for a specific period, the date of supply may also be examined.
- As part of checking taxpayers' compliance with the rules on the reverse-charge mechanism, the NAV will also review transfers of tradeable rights to emit greenhouse gases.

*Zsuzsanna Miskolczi*  
*+36 1 461 9212*  
*zsuzsanna.miskolczi@hu.pwc.com*

### DID YOU KNOW? ITALY

#### Increase of Italian standard VAT rate from 20 to 21%

The standard VAT rate in Italy has been increased from 20 to 21%. With effect as from 17 September 2011.

*Alessia Angela Zanatto*  
*+39 02 91605728*  
*alessia.angela.zanatto@it.pwc.com*

## **THE NETHERLANDS**

### **20. Ruling on the qualification of services for mortgage providers – Article 135(1)(d) of the VAT Directive**

*Intermediation services for mortgage providers - exempt transaction – application of banking resolution – scope of Axa UK plc – relevant for companies providing collection services*

On 7 July 2011 the court of appeal (Hof Amsterdam) decided on an appeal in a case considering several services related to mortgages. The taxpayer is a service provider in the market for mortgages and provides two distinct services; service A and service B.

#### *Service A*

The first service is related to the preliminary stage in the engagement between the credit provider and the credit receiver. The taxpayer provided computer software which was used by the credit provider to decide whether or not to provide credit to the credit receiver. The taxpayer was not involved in the execution of the software and there was no relation between the credit receiver and the taxpayer regarding the review of the credit party. The court decided that these services were of a mere administrative and technical nature.

#### *Service B*

On the other hand the taxpayer provided a service in which it took care of the payment and the collection of all the monies resulting from the mortgage deals. The

services considered, among other things the payment of the amount of the loan to the debtors' of the credit providers, the collection of interest, expenses and redemption of the mortgage loan and informing the credit providers and debtors' regarding the changes in the loan resulting from these movements. In order to execute these services the taxpayer had the authority to use the bank accounts of the credit providers both for the payment and collection of the amounts in question. Furthermore, the taxpayer has agreed upon a limited liability.

The Court ruled that the service should be qualified as a service exempt under the equivalent of Article 135(1)(d) of the VAT Directive. The main characteristic of the service is the transfer of money which results in the adjustment of the legal and financial relationship between the credit provider and the credit receiver and their banks. This is not influenced by the fact that the taxpayer's liability is limited to the failure to fulfill an obligation accountable to her and is financially maximised to a certain amount.

If the service of the taxpayer should be qualified as a service related to collection of debts the exemption provided in article (135)(1)(d) is not applicable. Following the judgment of the ECJ in Axa UK plc (C-175/09) all forms of debt collection could be excluded from the exemption. However, in a specific Dutch Decree of the Dutch Ministry of Finance of 25 July 1979 ("Bankenresolutie") passive debt collection is regarded to be exempt. The court ruled that the services provided in the present case should be qualified as normal debt collection and states that the taxpayer can, based on the principle of legitimate expectation, rely on this resolution.

Not all forms of collection of monies are qualified as debt collection.

The Dutch Tax Authorities have appealed against this judgement. It is now to the Dutch Supreme Court to deliver its views.

*Frans Oomen*  
*frans.oomen@nl.pwc.com*  
*+31 88 792 5156*

## **21. Court of Arnhem rules on actual use method to determine the proportional deduction – Article 173 of the VAT Directive**

*Proportional deduction – turnover or actual use – actual use method must be objective and precise*

On 14 July 2011 the Court of Arnhem (Rechtbank Arnhem) decided on a case considering the determination of the proportional deduction. The taxpayer is active in the business of selling, renting out and financing new and used cars. The finance activities are exempt from VAT, the other activities are taxed.

The Court has to decide whether the proportional deduction for general costs should be based on turnover or on actual use. From previous case law it follows that the party that wants to defer from a proportional deduction based on turnover has to prove that actual use is a more appropriate way to establish the proportional deduction. The actual use must be determined objectively and precise. If this is not possible, the proportional

deduction must be based on turnover, even though the actual use differs from the turnover ratio. After all, the turnover is a proxy to determine the proportional deduction.

The tax authorities argue that the proportional deduction should be based on actual use. They base this actual use on the average of the annual outstanding financing contracts. The tax authorities believe that the taxpayer is a financing company and the supply of cars is just a way to provide security with respect to these finance activities to the dealers. Furthermore, there is only a small profit made on the sale of the cars (a couple of euro's for each car).

The Court understands that because of the small profit on the sale of the cars and its big influence on a turnover based proportional deduction, that the tax authorities try to determine the proportional deduction on actual use. However, even though the method used by the tax authorities can be objectively determined, it is not precise enough to determine the proportional deduction on the basis of actual use. Therefore the basic rule applies and the proportional deduction should be based on the turnover.

If the method to determine the actual use is not objective and precise the proportional deduction must be based on the turnover, even if it significantly deviates from the (believed) actual use. The tax authorities have not appealed against this judgement.

*Gert-Jan van Norden*  
*gert-jan.van.norden@nl.pwc.com*  
*+31 88 792 1607*

**DID YOU KNOW?  
THE NETHERLANDS**

**Appeal of the tax authorities in lead generation case**

The Dutch tax authorities appealed against the decision of Rechtbank Arnhem regarding its judgement in a case considering lead generation (see also FS VAT Alert May 2011). In this case the court decided that lead generation can be qualified as intermediation for insurance services and is therefore exempt.

*Frans Oomen*  
*frans.oomen@nl.pwc.com*  
*+31 88 792 5156*

## **UNITED KINGDOM**

### **22. VAT and temporary workers - Decision in the Reed Employment case**

The First Tier Tribunal has given its decision in the Reed Employment case. This decision has generated debate about the correct VAT liability of the introduction of temporary workers by recruitment agencies, and whether an opportunity exists for retrospective VAT recoveries.

If you're considering how this decision will affect your business, then our webinar can help you get to grips with the possible challenges. You can click here to see the webinar.

In this webinar, we discuss the implications of the decision. We put the Tribunal decision into context, look at what was decided and consider how recruiters and

users of temporary workers can work together to ensure that the correct amount of VAT is being accounted for. We also look at the practical steps that will be necessary to achieve this.

You can read in further detail on the case in our bulletin.

If you'd like to find out more about the Reed Employment decision you can contact Stephen Morse on +44 20 721 22728, or Catherine Mattingley on +44 2920 802647.

### **23. Tax authority successful in deal costs VAT appeal**

The Upper Tribunal has upheld an appeal by the UK tax authority (HMRC) in a case concerning the entitlement of a bid vehicle to recover VAT on costs incurred in the course of a successful corporate takeover. Following the takeover, the bid vehicle joined the target company's VAT group and sought to recover the VAT incurred, but the Upper Tribunal decided that the costs did not have a sufficiently direct and immediate link with the taxable business of the target company to permit recovery. It also held that there was no evidence that, when the VAT was incurred, the bid vehicle had intended to join the VAT group.

The taxpayer has been granted leave to appeal the decision of the Upper Tribunal to the Court of Appeal.

*Jo Bello*  
*+44 (0) 20 780 43147*  
*jo.bello@uk.pwc.com*

## **24. Some news from HMRC and the Ministry of Finance**

- *HMRC's old bank accounts closed*

HMRC's bank accounts have changed.

With effect from 9 August 2011, you will no longer be able to use the Bank of England accounts. Any payments directed to the Bank of England accounts after this date will be rejected automatically by the banking system and returned to your bank.

This will result in a delay in getting your payment to the correct account and carries with it the risk of you incurring late payment penalties and interest if your payment does not reach the correct account by the payment due date.

To ensure that your payment reaches your record without delay, it is essential that you use the correct bank account information.

Please check the HMRC website if you require further clarification.

- *Tax authority consultation on cost sharing VAT exemption*

As announced in the coalition Government's Emergency Budget in 2010, the UK tax authority, HMRC, has launched a consultation document, 'VAT: cost sharing exemption' seeking the views of UK organisations on the introduction of exemption from VAT for shared costs, bringing the UK into line with EU law. Responses to the consultation were to be filed by 30 September 2011.

- *HMRC Litigation and Settlement Strategy (LSS) refreshed*

The LSS sets out HMRC's principles for handling all disputes about taxes, duties or credits, where subject to civil law procedures and whether resolved by agreement or litigation. The refreshed LSS retains the key themes of the original 2007 version but recognises the need to cut the number of outstanding tax disputes and bring in cash. This includes most of HMRC's compliance activity.

- *Proposed 'binding opinion' service for taxpayers*

The Ministry of Finance has released for comment a proposal which analyses the current status of sharing information relevant for taxpayers from the point of view of the tax administration. Under these proposals, taxpayers could request a 'binding opinion' from the tax authorities at a cost of Euro 2,000.

- *Proposed anti-VAT fraud measures*

The Ministry of Finance has submitted the 'Proposal of Concept of Battle against VAT Fraud' which was approved by the government in May 2011. The document includes proposed measures to request more information about applicants for VAT registration on the application form, limitation of cash payments in business transactions, and implementation of a new electronic VAT report which VAT payers will be obliged to file to declare the supply of goods and services divided according to customers and amount of VAT.

- *Tax authority consultation on extending online VAT services*

The UK tax authority, HMRC, has issued a consultation document concerning the continued computerisation of its dealings with VAT-registered businesses. The document features a proposed extension of the requirement to submit online VAT returns to businesses with turnover below £100k with effect from April 2012.

- *Tax authority publications on litigation and dispute resolution*

The UK tax authority, HMRC, recently refreshed its Litigation and Settlement Strategy (LSS) and also published draft detailed internal guidance on the LSS and its approach to using Alternative Dispute Resolution (ADR). Although there is little that is novel in these documents for dispute resolution specialists, this is the first time this level of detail has been published and there will be much of interest to businesses.

The draft ADR guidance is available on the HMRC website.

*Jo Bello*  
*+44 (0) 20 780 43147*  
*jo.bello@uk.pwc.com*

**DID YOU KNOW?  
SPAIN**

**VAT on new housing reduced to 4%**

Reduction of the Spanish rate from 8% to 4% for the supplies of buildings or parts thereof used exclusively as dwelling, including garages (maximum two) and annexes thereto. This reduced rate only applies for the transfers made between 20th August 2011 to 31st December 2011.

*Patricia Ferrer Torres*  
*+34 915 684 520*  
*patricia.ferrer.torres@es.pwc.com*

**DID YOU KNOW?  
SLOVAK REPUBLIC**

**Proposal to process import VAT via VAT returns**

The Ministry of Finance has proposed a new reverse charge system of accounting for import VAT. Under the proposals, eligible taxpayers would account for the VAT due via their VAT return, as opposed to the current system of paying import VAT to the customs office before the goods are released. The proposed implementation date for the new system is 1 January 2013.

*Valeria Kadasova*  
*+421259350626*  
*valeria.kadasova@sk.pwc.com*

## Contact

For more information, please do not hesitate to contact your local PwC Indirect Tax expert or one of the experts mentioned below:

### Austria

Christoph Wagner  
tel: +43 1 501 88 36 41  
christoph.wagner@at.pwc.com

### Belgium

Thierry Noël  
tel: +32 2 710 7344  
thierry.noel@pwc.be

### Bulgaria

Nevena Haygarova  
tel: +359 2 9355 162  
nevena.haygarova@bg.pwc.com

### Cyprus

Chrysilios Pelekanos  
tel: +357 22 555 280  
chrysilios.pelekanos@cy.pwc.com

### Czech Republic

Martin Diviš  
tel: +420 25115 2574  
martin.divis@cz.pwc.com

### Denmark

Jan Huusmann Christensen  
tel: +45 3945 9452  
jan.huusmann.christensen@dk.pwc.com

### Estonia

Tanja Kriisa  
tel: +372 614 1977  
tanja.kriisa@ee.pwc.com

### Finland

Juha Laitinen  
tel: +358 9 2280 1409  
juha.laitinen@fi.pwc.com

### France

Stéphane Henrion  
tel: +33 1 56 57 41 39  
stephane.henrion@fr.pwc.com

### Germany

Felix Becker  
tel: +49 69 9585 6665  
felix.becker@de.pwc.com

### Greece

Mary Psylla  
tel: +30 210 687 4543  
mary.psylla@gr.pwc.com

### Hungary

Tamas Locsei  
tel: +36 14 619 358  
tamas.locsei@hu.pwc.com

### Ireland

John Fay  
tel: +353 1 792 8701  
john.fay@ie.pwc.com

### Italy

Alessia Angela Zanatto  
tel: +39 02 91605728  
alessia.angela.zanatto@it.pwc.com

### Latvia

Ilze Rauza  
tel: +371 6 7094512  
ilze.rauza@lv.pwc.com

### Lithuania / Belarus

Kristina Krisciunaite  
tel: +370 5 239 2365  
kristina.krisciunaite@lt.pwc.com

### Luxembourg

Marie-Isabelle Richardin  
tel: +352 49 48 48 3009  
marie-isabelle.richardin@lu.pwc.com

### Malta

David A. Ferry  
tel: +356 2564 6712  
david.ferry@mt.pwc.com

### The Netherlands

Frans Oomen  
tel: +31 88 792 51 56  
frans.oomen@nl.pwc.com

### Norway

Yngvar Engelstad Solheim  
tel: +47 95 26 06 57  
ynvar.solheim@no.pwc.com

### Poland

Marcin Chomiuk  
tel: +48 22 523 4807  
marcin.chomiuk@pl.pwc.com

### Portugal

Mario Braz  
tel: +351 213599652  
mario.braz@pt.pwc.com

### Romania

Diana Coroaba  
tel: +40 21 202 8693  
diana.coroaba@ro.pwc.com

### Slovakia

Valeria Kadasova  
tel: +421 2 59 350 626  
valeria.kadasova@sk.pwc.com

### Slovenia

Marijana Ristevski  
tel: +386 1 583 6019  
marijana.ristevski@si.pwc.com

### Spain

Miguel Blasco  
tel: +34 9 1568 4798  
miguel.blasco@es.landwellglobal.com

### Sweden

Lars Henckel  
tel: +46 8 5553 3326  
lars.henckel@se.pwc.com

### Switzerland

Tobias Meier Kern  
tel: +41 58 792 43 69  
tobias.meier.kern@ch.pwc.com

### United Kingdom

Jamie Randell  
tel: +44 207 213 8253  
jamie.t.randell@uk.pwc.com

### United States

Ossie Osman  
tel: +1 646 471 1820  
o.osman@us.pwc.com

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