



A Step-by-Step Guide to Solving VAT Problems

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Value Added Tax (VAT) within the EU has become such a complex topic that a systematic approach is of paramount importance in order to solve VAT problems. The present article focuses on such an approach that could, when followed, become an invaluable aid for both businesses and VAT advisors.


Legislation: Directive and Regulations

The complexities arise from the way the EU VAT system is set-up. There is on the top of the pyramid the VAT Directive¹. Once a Directive has been enacted, it is binding, but each Member State (MS) is afforded the discretion of choosing the form and method of how to transpose its provisions into their national legislation. Thus the VAT Directive is harmonized in the Cyprus legislation through the VAT Laws of 2000, Law 95(I)/2000 and its Regulations, Decrees and Notifications; in the United Kingdom through the Value Added Tax Act of 1994; and so forth. In addition, the European Commission (EC) issues regulations from time to time as a preferred legal instrument through which to aid the harmonization process. The MSs are obliged to implement the Regulations but these do not require them to be transposed into local legislation – they are binding in their entirety and have a general and direct application.

An interesting point to note is that where a MS's national legislation is not in line with the VAT Directive, the VAT Authorities cannot refer to the VAT Directive – they are bound and must follow what their national VAT legislation provides for. A taxable person however *can* refer to the provisions of the VAT Directive directly when discussing with the tax authorities of his/her MS a point where the national VAT legislation has not implemented correctly a provision of the Directive. This is because the directives have a *direct effect*. However, European Court of Justice (ECJ) court rulings have also confirmed that not all provisions of a Directive have a direct effect – only those that are sufficiently precise and unconditional.

Since its enactment, the current VAT Directive, which is a recast of the previous Sixth VAT Directive, has been amended by no fewer than twelve amending Council Directives, and in addition has been amended by the Treaty of Accession of Croatia and further corrected through two corrigenda. Many of these amendments and many of the Implementing Regulation Provisions that exist, arose because of non-uniform interpretation of the VAT Directive provisions across the MSs. This non-uniform interpretation leads to confusion, increased compliance costs and ultimately economic

¹ Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, as amended.



harm to the multinational businesses that rely more and more on cross-border transactions.

Language and Interpretation

The VAT Directive is meant to promote a uniform system across the 28 MSs. Although the VAT Directive itself has been translated in all 24 official languages of the EU, this is not always possible to do for all the underlying documents as well. For example one of the recent but important amendments, the so called Invoicing Directive² which came into effect on 1 January 2013 (although Cyprus did not manage to transpose it into its national legislation until 20 December 2013), was so important that explanatory notes were also published alongside the amending directive. Such explanatory notes, although not legally binding on the MSs, were important for explaining the philosophy and underlying purpose of the amendments. Yet at the time of writing this article, these only existed in 21 languages.

Every language version is as binding as each other. This means that in the case of a difference arising from translation, there is no language version that prevails. ECJ rulings have confirmed that a MS may not apply against an individual a regulation which at the time of its application has not been properly published in the Official Journal of the EU in the official language of that MS. This has resulted in some problems arising from time to time, although this is admittedly not the biggest challenge that exists.

Options and Derogations


The VAT Directive offers several instances where MSs are allowed to exercise various 'options to tax' or 'options to exempt' a transaction, or more generally 'options to derogate' from the provision in an article. This has created a very *non*-uniform VAT base across the EU. The issue is compounded by the fact that the VAT Authorities across the MS have their own interpretation of the VAT provisions, which are not always in line with each other. The ECJ offers guidance on interpretation of specific provisions, only when a relevant case is referred to it.

It is not the purpose of the present article to exhaustively address such problems. They are mentioned for the purpose of highlighting the starting point for VAT advisors when confronted with a VAT question. VAT queries are seldom straightforward given the vast and broad legislative background. Here is how they should be tackled.

Tackling VAT problems

In analyzing any VAT scenario, there are five main questions that the tax advisor should answer before providing any advice. These questions should be asked in the precise sequence stated below. The answers are crucial in understanding the problem at hand, and therefore in being able to advise correctly. The present article does not explain and

² Council Directive 2010/45/EU of 13 July 2010



analyze the VAT legislation, and does not offer detailed VAT knowledge, which is required to answer each question. The systematic approach below offers a logical thought-process, or path of knowledge, to assist us in finding the solution to a VAT query.

1. The question of taxable person.

The first question addresses who is supplying and who is the customer. The VAT Directive defines a taxable person in Article 9 as any person who, independently, carries out in any place any economic activity whatever the purpose or results of that activity. Yet the question here goes beyond trying to understand if the supplier or customer meets this definition.

Establishing whether a taxable person exists is the first step to understanding the transaction. If there is no taxable person, then there is no transaction to tax. The only two exceptions are where a non-taxable person is selling a *new* means of transport to another person in another MS, and the case where a non-taxable person opts to be considered a taxable person when selling a new building (in order to recover input the VAT). With regards to the latter, not all MS have such an option in their legislation.

If however a taxable person *does* exist on the supplying end, then the transaction could be a business-to-consumer (B2C), which entails one set of rules; and if a taxable person also exists on the receiving end, then there is a business-to-business (B2B) relationship, governed by other rules.


Specifically, the VAT advisor needs to ascertain whether the transaction under review involves:

- (a) a taxable person with the right of deduction;
- (b) a taxable person without the right of deduction (eg a university);
- (c) a taxable person that follows a special scheme of small undertakings or the special scheme for farmers;
- (d) a non-taxable legal person (eg a government); or
- (e) a non-taxable person.

Every one of the above carries different implications of how VAT may be applied. It is thus imperative to have a solid understanding of whether a taxable person exists and if yes, then what category of taxable person it is.

2. The question of taxable transaction.

There are only four types of taxable transactions. Identifying the correct one is the next step, following the identification of whether a taxable person exists. These four types are identified in Article 2 of the VAT Directive, and are as follows:

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- (a) supply of goods (this includes 'exports' which are zero rated³);
 - (b) supply of services;
 - (c) intra-community acquisition of goods; and
 - (d) imports.

Identifying which of the four transactions is taking place, in conjunction with the type of taxable or non-taxable person, are paramount to understanding the VAT treatment of the transaction. Once the above have been determined, the VAT adviser can proceed with question 3.

3. The question of place of the taxable transaction.

The place of supply is arguably one of the most challenging questions, mainly because of the number of special rules that exist. In addition, this is an area where derogations and options that exist in the VAT Directive will mean that local legislation will differ between MSs. This means that the VAT advisor must use the correct rule based in local national rules, in the country where the place of supply is deemed to take place.

There are different rules that determine the place of supply of goods and the place of supply of services.

(a) place of supply of goods


Indicatively, for the place of supply of goods, this could be:

- The place where the goods are (eg when the sale of goods are not transported, or in the case of distance sales that fall below the registration threshold in the other MS);
- The place where transport begins (eg when the goods are transported);
- The place where goods are installed or assembled;
- The place where transport ends (eg for intra-community acquisitions); or
- The place where the customer is established (eg for intra-community supplies).

In addition, special rules exist for intra-community acquisitions that result from triangulation or ABC transactions.

The rules governing chain transactions in general require particular attention, as several factors themselves may influence the decision of whether and where VAT is due. For example, if in a chain transaction the original supplier is outside of the EU (eg Switzerland or Norway), then the question of who undertakes the importation as well

³ I would like to clarify that the VAT Directive does not refer to the term 'zero rated', nor does such a term exist in all MSs. The Directive refers to exemptions. Therefore 'zero rated' is where an exemption with right of deduction exists. An 'exempt transaction', as per the Cyprus VAT legislation, is thus a transaction for which no right of deduction exists.



as who is responsible for the transportation is fundamental to the decision-making process.

There are separate rules governing the supply of goods on board ships, aircrafts or trains, which also need careful consideration. Let us take the example of a train travelling from Amsterdam in the Netherlands to Rome in Italy, and then back to Amsterdam. The train makes stops in Brussels of Belgium, Frankfurt of Germany, Berne of Switzerland, Milan and finally Rome, the last two stops being in Italy. Any goods sold between Amsterdam and Frankfurt will be subject to Dutch VAT, and any goods sold between Milan and Rome subject to Italian VAT. From Frankfurt to the Swiss border, any goods sold would be subject to German VAT. The problem arises when the train enters Switzerland. In theory and given that the train does not stop on the Swiss border, any goods that the train carries at that point that are available for sale are being exported, and subsequently imported when arriving in Italy from Switzerland. Again theoretically, an Italian VAT Inspector on the train can demand Italian VAT on the 'import' in Italy. It is for this reason that during such a journey, one may find that the food trolley (being goods) will be locked away at Frankfurt and unlocked in Milan! On the return leg, Italian VAT will apply to any goods sold between Rome and Milan, and German VAT on goods sold between Frankfurt and Amsterdam.

There are also special rules governing the sale of gas, electricity, heat and cooling energy sold through gas systems or energy networks, between taxable persons. The thing to note here is whether the customer will purchase the good (eg the gas) for own consumption (in which case VAT is payable in the country of consumption) or for resale (in which case VAT is payable where the customer is established).

Special note in addressing the place of supply question should be given to imports. The place of supply for imports is the country where the goods enter the community. However, it could instead be the MS where such goods cease to be covered by customs arrangements.

(b) Place of supply of services

For place of supply of services, the 2010 amendment⁴ to the VAT Directive was meant to simplify these rules. The initial concept was indeed simplified: for B2B transactions, the place of supply is where the customer is established, and for B2C transactions, the place of supply is the country of the supplier. However, the MSs, in negotiating the rules, and in fear that businesses and consumers would chose the MS with the lowest rate of VAT, also imposed special place of supply rules, in addition to the general B2B and B2C rules explained above. The result was even more complicated rules, allowing for a total of 15 derogations, nine of which only apply to B2C transactions, one which applies only to B2B transactions, and five of which apply to both B2B and B2C transactions. A detailed explanation of these rules would require a separate article (or chapter!). For the

⁴ Council Directive 2008/8/EC of 12 February 2008

purpose of this article, I have prepared the table below, which summarizes, in simple terms, the place-of-supply-of-services rules.

Rules relating to both B2B and B2C transactions	
Type of service	Place of supply
Connected with immovable property	Where immovable property is located
Passenger transport	Where transport takes place
Restaurant and catering services	Where services physically carried out
Restaurant and catering services on board ships, aircrafts or trains within the EU	Point of departure
Short-term hiring of means of transport	Where means of transport is put at disposal of customer
Rules relating to B2C transactions only	
Type of service	Place of supply
Intermediaries	Where underlying transaction takes place
Transport of goods, other than intra-community transport	Where transport takes place
Intra-community transport of goods	Place of departure
Services and ancillary services relating to cultural, artistic, sporting, scientific, educational, entertainment and similar activities	Where the activities take place
Valuations of, and work on, movable tangible property	Where services physically carried out
Ancillary transport activities (eg loading, handling)	Where services physically carried out
Long-term hiring of means of transport	Where customer is established
Electronically supplied services (from 1.1.2015)	Where customer is established
Various intangible services when customer is outside the EU	Where customer is established
In all other cases	Where the supplier has established his business
Rules relating to B2B transactions only	
Type of service	Place of supply
Admission to cultural, artistic, sporting, scientific, educational, entertainment and similar events, including ancillary services to the admission	Where the events take place
In all other cases	Where the customer has established his business

Once the place of supply of the transaction has been determined, the fourth question can be addressed.

4. The question of exemptions.

Different exemptions exist in the legislation and due care should be given to determine whether the transaction under review is covered by one of the exemptions. If an exemption exists, there is no VAT.

The exemptions could arise as a result of:

- Exports;
- Intra-community supplies;
- International transport;
- Supplies to vessels or aircrafts;
- Supplies under diplomatic and consular arrangements; or
- Supplies under VAT warehousing arrangement.

If no exemption exists, then question 5 should finally be addressed.

5. The question of the person liable to pay the tax.

Once the above have been established, the question of who is liable to pay the tax is not always straightforward. The liability rules are important and complicated. Certain provisions of the VAT Directive, such as Article 196, which discusses the reverse charge on services received from outside of the recipient's MS, are uniform across the 28 MSs. Others, such as Article 194, which allows for MS to decide whether the recipient of a service, which is carried out by a supplier outside of that MS, should account for the VAT, are different across the MS. So it is imperative to have knowledge of the local legislation of the country where the supply takes place, and determine whether the person liable to pay the VAT is:

- (a) the supplier;
- (b) the customer;
- (c) the person to whom the services are supplied; or
- (d) a tax representative.

The VAT advisor, in answering the above should also be aware if the client has multiple VAT registrations in other MSs, and the reasons behind such registrations, as this may determine the answer to question 5.

Note:

The information contained in this article is issued as guidance only and is accurate as at the date of its publication.

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