Issue No. 5, June 2015

VAT Newsletter

Important VAT, GST and sales tax news from around the world

Introduction

Welcome to the fifth issue of Ernst & Young LLP's *VAT Newsletter* for the US and Canada. These newsletters cover a variety of topics, as value-added tax (VAT) can impact businesses in many ways. Approximately 160 countries now have a VAT, goods and services tax (GST), consumption tax, service tax or similar VAT, and the laws and regulations are constantly changing. We use this newsletter to inform you of significant changes taking place.

At the end of this newsletter, you will find contact details for the senior members of our teams in the US and Canada who can help answer any questions you may have about the articles in this newsletter or any other VAT questions.

We are interested in your feedback on the items covered and what topics you would like to see covered in the future. Please provide any feedback to Howard Lambert at **howard.lambert@ey.com**.

If you would like to subscribe to EY's other Indirect Tax Updates, please click **here**.

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Global

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You can access the latest guide **here**.

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Managing indirect tax controversy: dealing with audits and disputes

Managing indirect tax controversy is our new Global Indirect Tax thought leadership report, providing insights into how companies can anticipate and deal effectively with tax audits and resolve disagreements with tax administrations. You can access the report **here.**

Americas

Argentina — Tax authorities extend electronic invoicing system to all VAT taxpayers

The tax authorities for the City of Buenos Aires have indefinitely suspended the turnover tax withholding system for nonresidents for revenue derived from internet use, while the Province of Buenos Aires has established provisions implementing a turnover tax withholding system for nonresidents.

Background

The turnover tax is an indirect provincial tax imposed by the tax authorities in each of the 24 jurisdictions in Argentina (including 23 provinces and the City of Buenos Aires).

Typically, the tax applies to gross revenues derived from activities carried out in each jurisdiction. The rates typically vary between 3% and 5% for the sale of goods and services.

In the past, foreign entities with no permanent establishment in the country (for instance, through a branch or subsidiary) were not subject to this tax. Through the issuance of several laws and resolutions, however, some provinces have established turnover tax withholding systems applicable to foreign entities.

City of Buenos Aires

The City of Buenos Aires Tax Authorities (AGIP) indefinitely suspended the turnover tax withholding system (which was initially intended to become effective on 1 November 2014, but never entered into force) for revenue derived from the use of the internet to access movies, TV series, games, music, videos and other similar services when payments are made to nonresidents with credit or debit cards.

Resolution No. 593/2014 previously required credit and debit card issuers involved in processing the payments to foreign service providers to act as withholding agents for internet activities described above.

The turnover tax withholding rate was 3% of the net price and was to be withheld before the funds were transferred abroad. The withheld amount was supposed to be treated as the turnover tax payment for the foreign service providers.

Province of Buenos Aires

Through Law No. 14,653, the Province of Buenos Aires established the initial provisions for implementing a turnover tax withholding system on nonresidents for revenue derived from certain activities carried out in the Province of Buenos Aires.

The law establishes that the resident contractor, organizer, administrator, user, holder or payer of the taxable activities will be responsible for making the tax payment. The Province of Buenos Aires Tax Authorities (ARBA) still must define many aspects of the system, such as the activities subject to the tax, the tax rates and the methods for making the tax payment. Therefore, the system does not yet apply.

Implications

These developments from the City of Buenos Aires and the Province of Buenos Aires entail unprecedented dispositions, which can potentially show a new trend in the provincial taxation of cross-border transactions.

Foreign companies involved in the provision of services to Argentine residents, as well as local residents acting as recipients of those services, should monitor the developments in this area.

Puerto Rico — First US jurisdiction to adopt VAT system

Executive summary

On 29 May 2015, the Governor of Puerto Rico signed into law Act 72-2015 (Act 72), which amends various provisions of the Puerto Rico Internal Revenue Code of 2011, as amended (the Code). Although Act 72's most notable provision is the introduction of a value added tax as of 1 April 2016, it also includes amendments to the sales and use tax (SUT), income tax and excise tax under the Code and introduces a mechanism to facilitate the exchange of taxpayer information between government agencies.

This article focuses on the changes relating to the VAT[1] and the SUT. Below are some general highlights of the indirect tax changes introduced by Act 72.

Detailed discussion

VAT

Even though Act 72 provides an effective date of 1 April 2016, for the VAT, this date depends on a finding by the Consumption Tax Transformation Alternatives Commission (CATIC by its Spanish acronym), a group also created by this new law, that no other viable alternatives exist that meet the Government's tax revenue objectives while allowing a reduction in the tax burden shouldered by individuals. The CATIC must submit its report to the Governor and the legislative assembly no later than 28 July 2015.

At this time, the role of the CATIC in altering the course of the VAT is likely to be perfunctory. The Commonwealth's decision to move toward a VAT implementation resulted from an exhaustive study of the available tax system alternatives. The CATIC was a last-minute addition to this piece of legislation, aimed at harnessing the votes necessary for enactment in the legislative assembly. In addition, Act 72 grants the Puerto Rico Secretary of the Treasury authority to extend the effective date of the VAT by 60 days, until 1 June 2016, in the event the Puerto Rico Treasury Department's operations are not ready by the initial implementation date.

Once the VAT comes into effect, it will be imposed at a maximum rate of 10.5% and will coexist with the 1% municipal SUT. Thus, the SUT provisions of the Code will remain in effect to the extent they relate to certain transactions subject to tax at the municipal level.

SUT

The more immediate effect of Act 72 will be the SUT rate increase from 6.0% to 10.5%, effective 1 July 2015, in addition to the retention of the 1.0% municipal SUT under the Code; thus, total combined SUT will be as high as 11.5%. Also, a 4.0% SUT is imposed on certain business-to-business (B2B) services and designated professional services rendered between 1 October 2015 and 31 March 2016; these services will not be subject to the municipal SUT during this period. Merchants rendering designated professional services will be allowed to use the cash method of accounting even if they use the accrual reporting basis after 30 September 2015.

Furthermore, for periods commencing after 30 June 2015, the 75% SUT credit limitation is eliminated, and merchants will be able to claim SUT credits up to the full sales tax obligation. Unused SUT credits generated before 1 April 2016, will be available to reduce the VAT obligation until fully exhausted, but with no refund option.

Act 72 also provides for a phased payment mechanism for the SUT obligation related to transactions taking place during July 2015 (i.e., the month of the rate increase) to be remitted in the following manner:

- 55% will be paid on or before 20 August 2015.
- 45% will be paid in three equal installments due on or before the 20th day of the following three months (September, October and November).

As part of its transition-period provisions, Act 72 provides that the sale of taxable items covered by contracts or auctions that were executed or awarded before 1 July 2015, will be subject to the tax rate in effect on 30 June 2015. The tax rate will be valid for the lesser of 12 months or the duration of the contract. For taxable services, the lower SUT rate will apply only if the services are paid before 1 July 2015. Also, Act 72 introduces a requirement to register certain preexisting construction contracts for commercial, industrial and housing projects in order to benefit from the lower rate in effect on 30 June 2015.

The table below summarizes the major SUT rate changes introduced by Act 72.

	29 May 2015 – 30 June 2015	1 July 2015 – 30 September 2015	1 October 2015 – 31 March 2016
Central Gvt. SUT rate	6 %	10.50%	10.50%
Municipal SUT rate	1%	1%	1%
B2B and designated professional services	0%	0%	4% (no Municipal SUT)
Available SUT credit (only to resellers of tangible personal property)	75% of current SUT return liability	100% of current SUT return liability	100% of current SUT return liability

[1] *For a high-level discussion of the things that businesses operating in Puerto Rico must be doing to prepare for VAT implementation, see EY Global Tax Alert, Puerto Rico continues efforts to become a VAT jurisdiction, dated 16 April 2015.*

Asia-Pacific

Australia — Levying of GST on electronic services purchased from abroad: draft legislation

On 11 May 2015, one day before the Australian Federal Budget, the Australian Treasurer released a statement foreshadowing a measure imposing GST on inbound digital (or electronic) services. The **media release** stated that Australia will look at "levelling the playing field for GST" in relation to supplies of digital products and services in Australia by offshore suppliers, and that draft legislation would be published on 12 May 2015. Our global tax alert comments on the pre-Budget announcement can be found **here**.

On 12 May 2015, as part of the Australian Budget announcements, the Australian Government published a report entitled **Budget 2015: Fairness in Tax and Benefits,** which contains details on the application of GST to digital products and services imported by Australian consumers, together with **draft legislation (and associated explanatory material)** that would amend the GST law to give effect to this measure. Our **Australian Budget alert** contains further details.
The draft legislation, which applies only to business-to-consumer (B2C) transactions (i.e., capturing the supply of electronic services by a foreign business to Australian private individuals), will apply to supplies made on or after 1 July 2017.

New Zealand — Proposal to tax online shopping

According to Prime Minister John Key, adding GST to online purchases is "inevitable." Retail NZ and Booksellers NZ's current **#eFairnessNZ** campaign is calling for urgent action to close this tax loophole.

It remains uncertain as to how this might be done and, as Key noted, different countries have different views around the best solution.

However, it is generally agreed that New Zealand must find a workable system it can implement relatively quickly if it wants to tax internet shopping.

Slow and expensive

Asking banks or credit companies to collect tax on internet shopping has been touted as an efficient solution, making tax avoidance difficult.

Nevertheless, there are some major acknowledged deficiencies with current online payment mechanisms, namely that they do not contain the detailed breakdown of a transaction that would be needed for tax purposes. Although information collection technology is developing at a fast rate, a technology solution is unlikely to emerge in the next 12 months, and is likely to have significant associated costs.

Boost duty free limit?

It may sound counterintuitive, but increasing the duty free limit could simplify matters and increase tax revenue, given the reporting complexities associated with duties. Variable rates of duty are determined by the origin of the goods, strict classification rules, valuation rules, tariff concessions and the impact of Free Trade Agreements, to name but a few.

If the duty free limit is increased and the GST threshold reduced, this could pave the way to a simple method of taxing online shopping and boosting tax revenue.

The most critical factor is the value of the goods. It's not necessary to distinguish between a T-shirt and a book because GST applies at 15%, regardless. But for duty purposes, it does matter whether you are importing a T-shirt (subject to duty) in contrast to a book (not subject to duty).

Although the government misses out on the collection of duty with standard rates of 5% and 10% (before the impact of Free Trade Agreements), GST can be collected at a flat rate of 15% on more transactions.

This approach is already in place overseas. The UK does not impose customs duty if the value of the goods does not exceed £135. However, VAT is imposed if the value of the goods is £15 or more.

Simplify declarations

A normal import entry for goods worth AUD1,000 or more requires more than 50 fields of information to be completed.

Import entries processed by Customs' new Joint Border Management System require much more information. A simplified import entry for goods costing less than AUD1,000 isn't particularly simple to complete as it removes only the need for the importer (including individual online shoppers) to have a client code (a registration number with customs). Only goods below the current low value import threshold of $400 (assuming duty is not applicable) and postal items are exempt from these requirements.

To tax online shopping, a simple mechanism of reporting would be required. With an increase to the duty free limit, the complexities could be removed with an import entry format for internet shopping focusing on the value of the imported goods.

Difficulty with downloads

This still leaves the difficult issue of taxing imports of intangibles (such as music downloads, e-books, downloads of games and software) that currently can't be taxed at the border by customs.

The most likely option at this stage would be for Inland Revenue to adopt the OECD proposals of requiring nonresidents to voluntarily register for GST and charge GST to their customers — similar to the approach adopted in South Africa.

South Korea — Levying of VAT on electronic services purchased from abroad

Key updates

- The proposed legislation on this issue was ratified on 23 December 2014, and a related VAT Enforcement Decree was ratified on 3 February 2015.
- The legislation is still scheduled to take effect from **1 July 2015**.
- Where an overseas vendor with no establishment in South Korea sells a "mobile application" to a South Korean customer, the vendor will be required to register for VAT in South Korea and account for local VAT on its supply.
- Open market providers and agents selling mobile applications on behalf of an overseas vendor may also be caught by the above rule.
- The definition of "mobile application" (according to the VAT Enforcement Decree) is broad and covers any electronic services (e.g., games, music, videos, software) that can be played, operated or executed via mobile communication devices, computers, etc.
- The legislation does not differentiate between supplies made to businesses and private customers. As such, we understand that the provisions are applicable to **both B2B and B2C** transactions (i.e., the vendor could be caught by the legislation regardless of whether the South Korean customer is a business or private individual).

Next steps to consider

- Businesses should consider whether they would be affected by the above legislation.
- If so, affected non-established businesses will need to VAT register using the simplified business registration facility on the Korean National Tax Service (NTS) website no later than **20 July 2015**. After this date, where a business fails to register for South Korean VAT within 20 days of commencing its business activity, a tax **penalty** equal to 1% of the value of supplies made may be levied.
- Please be aware that the NTS website has not been updated, and we are still awaiting the publication of detailed instructions regarding the simplified business registration process.

Europe

European Commission — EU study on the application and impact of VAT low value consignment relief

The European Commission has published a study (performed by EY) providing an assessment of the application and impact of the VAT exemption for the importation of small consignments, otherwise known as low value consignment relief (LVCR).

In general, imports of goods in the EU are charged with customs duties and VAT unless they are specifically exempt. LVCR was introduced in the EU in 1983. The relevant EU provisions allowed Member States to relieve imports of goods of a negligible value (not exceeding EUR22) from VAT and were intended as a method to facilitate cross-border trade by reducing the administrative burden and cost involved for businesses and Member States.

The growth in the volume of imported consignments in the EU, which appears to be largely driven by a boom in e-commerce, has put pressure on the existing LVCR arrangement. The current VAT Directive obliges Member States to exempt all commercial (B2C) importations of consignments with a value not exceeding EUR10 from import VAT. Member States are free to increase this threshold up to EUR22. Member States are also allowed to exclude mail order shipments from this arrangement, which would effectively remove the exemption for most of the consignments.

In view of recent recommendations that LVCR should be abolished and the current Mini One-Stop Shop (MOSS) regime should be extended to cover cross-border B2C sales of goods (i.e., distance sales), the study carried out for the Commission presents an overview of the legal framework and procedures in place in each Member State as regards the implementation of LVCR, as well as an economic analysis of the low value consignments market and its consequences (including an estimation of the potential VAT forgone by tax authorities due to this exemption).

An executive summary and the final report can be accessed by clicking **here** and **here,** respectively.

European Commission — Launch of strategy to create a digital single market

The European Commission has published details of its strategy to create a digital single market. A digital single market is one in which the free movement of goods, persons, services and capital is ensured and where individuals and businesses can seamlessly access and exercise online activities under conditions of fair competition, and a high level of consumer and personal data protection, irrespective of their nationality or place of residence. The Commission's strategy includes 16 targeted actions to be delivered by the end of 2016.

From a VAT perspective, the Commission will make legislative proposals in 2016 to reduce the administrative burden on businesses arising from the different VAT regimes applicable to cross-border sales. The planned VAT changes include:

- Extending the current MOSS regime to cover cross-border online sales of physical goods (i.e., distance sales)
- Introducing a common EU-wide VAT threshold
- Removing the VAT exemption for the importation of small consignments from suppliers in third countries (i.e., LVCR)

The Commission's press release, questions and answers fact sheet and more detailed communication on its strategy can be accessed by clicking **here**, **here** and **here,** respectively.

Slovenia — Proposal for introduction of the cash registers

The Slovenian Government is preparing a legislative proposal to introduce tax cash registers for businesses that trade in cash and are obliged to issue invoices.

The legislative proposal has not yet been adopted by the government. According to the Ministry of Finance, the proposed timing for introduction of cash registers depends on whether the Financial Administration will have to initiate a public tender for purchase of IT equipment for monitoring the cash registers. In case a public tender will be required, tax cash registers are expected to be in use as of 1 January 2016. If a public tender will not be required, tax cash registers would be in use already as of 1 October 2015.

Middle East, India and Africa

India — Further delays to the introduction of GST

After the passage of the Constitution Amendment Bill for Goods and Services Tax (the Bill) in the Lok Sabha on 6 May 2015, the Bill had been presented by the Union Finance Minister in the Rajya Sabha on 12 May 2015.

As per the opposition's demand, the Bill has been referred to the Select Committee of the Rajya Sabha.

The Committee has 21 members and is expected to submit its report by the end of the first week of the monsoon session of the Parliament scheduled to commence in the third week of July 2015.

GST implementation is likely to be delayed. It is important that the industry utilizes this additional time in getting GST ready.

Key GST updates

The Bill for GST in the Rajya Sabha:

- The Constitution Amendment Bill for GST was passed in the Lok Sabha on 6 May 2015 with two-third majority.
- In the Rajya Sabha, the opposition continued its insistence on a legislative scrutiny of the Bill and did not favor the passage unless it was referred to the Select Committee. The Bill has been referred by the government to the Select Committee of the Rajya Sabha.

Select Committee of the Rajya Sabha:

- The Select Committee comprises 21 members of the Rajya Sabha, across various ruling and opposition parties, and is chaired by Mr. Bhupender Yadav, a Member of Parliament (MP) from the ruling party of the State of Rajasthan.
- The committee will review the Bill and give its report by the end of the first week of the monsoon session of the Parliament.
- The monsoon session is expected to commence during July, 2015.
- It appears that concerns raised during the two-day Empowered Committee meeting last week (on 7-8 May) pertaining to a 1% additional tax, place of supply rules, GST council constitution, Revenue Neutral Rate, etc. would be addressed by the Select Committee.

The road map ahead:

- The Select Committee is expected to submit its report in the first week of the monsoon session. The monsoon session is scheduled to start from the third week of July.
- The suggestions, if any, in the report to be submitted by the Select Committee, will be discussed and consensus reached before Rajya Sabha passes the Bill with two-third majority.

- The government is committed to get the Bill passed in the monsoon session.
- The Bill thereafter will be needed to be ratified by at least 15 states in their respective assemblies before the president can give its assent for its enactment.
- A GST Council will be formed within 60 days of the enactment of the Bill.
- GST legislation and place of supply rules will be framed and put in the public domain for comments.
- The GST Network, an IT backbone of GST, which will facilitate online registration, tax payment and return filing, will be launched.
- States will frame their respective GST legislations to enable them to implement GST. It will be in line with the central GST legislation.

Turkey and Tanzania — Levying of VAT or local equivalent on electronic services purchased from abroad

A growing number of countries, aside from the EU Member States, have or are in the process of introducing new rules to impose VAT (or their local equivalent) on inbound digital services (i.e., electronic services supplied by a foreign business to local customers). These include Australia, Japan, Norway, South Africa, South Korea and Switzerland. The latest unofficial news is that Tanzania and Turkey are also considering introducing similar rules for inbound B2C supplies of electronic services.

EY newsletters and alerts

If you would like a copy of a green paper, newsletter or alert covering some of the topics mentioned below, please click on the link or contact Howard Lambert at **howard.lambert@ey.com**.

Croatia: *EY Tax News* – January 2015: Ernst & Young d.o.o. has issued the January 2015 edition of its regular client newsletter, *EY Tax News*. This edition features the important VAT, excise duty and tax procedure changes for 2015.

Czech Republic: *EY Tax News* – May 2015. Ernst & Young s.r.o. has issued the May edition of *EY Tax News*, its regular client newsletter. From an indirect tax perspective, this edition includes items on the VAT changes associated with the draft Sales Documentation Act and details of a Supreme Administrative court case on excise duties guarantees.

Hungary: ***EY Tax Express – May 2015***. Ernst & Young Tanacsado Korlatolt Felelossegu Tarasag's May edition of its regular client newsletter, *EY Tax Express*, advises of expected tax modifications (including VAT and other indirect taxes) related to the 2016 budget. The changes will enter into force from 2016, except for certain amendments concerning corporate taxation. The bill is expected to be passed in late June.

Italy: A global tax alert, *Italy considers introduction of tax on digital activities* was issued on 27 April 2015.

Netherlands: *Tax Update Weekly* – edition 17, 18, 19, 20, 21 and 22, 2015. Weekly e-newsletter regarding the latest updates of the most recent and relevant tax news from the Netherlands and the rest of the world.

UK: *VAT News* – weeks ending 27 April 2015, 4 May 2015, 11 May 2015, 18 May 2015 and 27 May 2015. Weekly client e-newsletter – roundup of VAT news from UK, EU and other countries.

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