

VAT Newsletter

Introduction

Welcome to the third issue of Ernst & Young LLP's 2015 *VAT Newsletter* for the US and Canada. These newsletters cover a variety of topics, as 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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EY's *2014 Worldwide VAT, GST and Sales Tax Guide*

EY's *Indirect Tax Briefing*, 11th edition

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Building a better
working world

Global

EY's 2014 *Worldwide VAT, GST and Sales Tax Guide*

You can access the latest guide [here](#).

EY's *Indirect Tax Briefing: a review of global indirect tax developments and issues*, 11th edition

You can access the latest briefing [here](#).

EY's *Indirect tax in 2015: A review of global indirect tax developments and issues*

You can access the annual report [here](#).

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Americas

Brazil – Increase in PIS-COFINS rates on imports of assets

Under Provisional Measure 688 (MP 688/2015), enacted on 30 January 2015, the Brazilian Government increased the PIS/COFINS (Social Contributions on Gross Revenues) combined rate from 9.25% to 11.75% for general import transactions.

In addition, MP 688/2015 provides specific PIS/COFINS rates for import transactions involving certain products/goods. The new combined rates include:

- ▶ Pharmaceutical products: 15.79%
- ▶ Cosmetics and personal hygiene products: 20%
- ▶ Certain machinery and equipment: 15.19%
- ▶ Rubber tires and inner tubes: 16.56%
- ▶ Certain auto parts: 15.19%
- ▶ Paper destined to journal printing: 4.76%

The PIS/COFINS combined rate applicable to the import of services remains at 9.25%. The provisions of MP 688/2015 will apply from 1 May 2015.

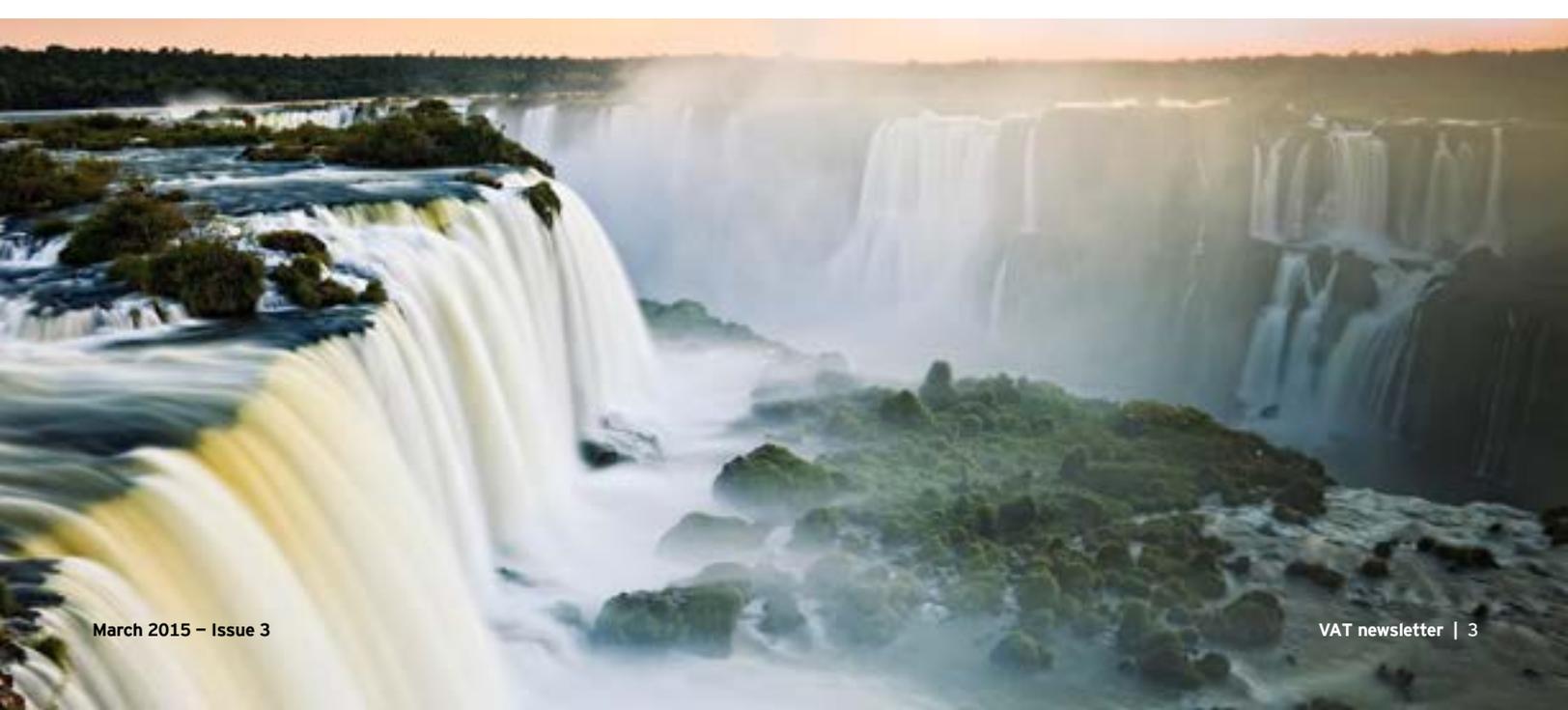
Brazil – IPI on certain cosmetics sold by wholesalers

Under Decree 8,393 (Decree 8,393/2015), enacted on 28 January 2015, the Brazilian Government imposed IPI (Excise Tax on Manufactured Products) on certain cosmetic products sold by wholesalers, when the wholesalers acquire such products from an industrial establishment that qualifies as an interdependent, controlled/controller or affiliated party.

Generally, IPI applies to sales made from industrial establishments to distributors. Under the provisions of Decree 8,392/2015, IPI on certain cosmetic products will apply both on sales made from industrial establishments to wholesalers and from the wholesalers to customers. The term “industrial establishment” not only comprises manufacturers, but also:

- ▶ Establishments that import foreign products
- ▶ Branches or establishments that commercialize products imported or manufactured by other entities of the same economic group
- ▶ Establishments that commercialize products manufactured by:
 - ▶ Another establishment belonging to the same entity (this means that both commercial and manufacturer establishments belong to the same legal entity)
 - ▶ Third parties with raw-material, intermediary products, packaging, containers, molds, matrices or models provided by such establishments

The provisions of Decree 8,393/2015 will apply from 1 May 2015.





Asia-Pacific

China – Credit system introduced for enterprises claiming tax refund on export

The State Administration of Taxation (SAT) issued an announcement on 7 January 2015 concerning the introduction of a credit system for enterprises that claim a VAT refund on exported goods. The credit system started with effect from 1 March 2015. From that date, all enterprises will, for VAT refund purposes, be classified into four categories, according to such factors as total net assets, credit rating, storage of documents, and whether there is a history of good conduct and tax compliance.

The following administrative procedures apply for each category:

- ▶ **Class 1** enterprises will be able to file an electronic return and do not need to submit original invoices in order to obtain the refund. Additionally, the tax authority will give priority to a Class 1 enterprise in handling the application for the VAT refund.
- ▶ **Class 2 and Class 3** enterprises will need to submit original invoices and other requested documents when filing the electronic return.
- ▶ **Class 4** enterprises will, in addition to all the invoices and documents required for Class 2 and Class 3 enterprises, have to present evidence to the tax authority that the payments relating to the export transactions have been settled.

Detailed rules are included with the announcement as to how enterprises will be appraised and classified. With the announcement, the SAT intends to increase efficiency in handling the tax refund procedure for bona fide enterprises and to focus on those enterprises that need to be monitored more in respect of tax compliance.

China – VAT refund for foreign visitors extended to the whole country

The Ministry of Finance issued an announcement on 6 January 2015 extending the pilot program of VAT refund for foreign visitors on consumer goods purchased in China to the whole country.

The pilot program was launched in Hainan in 2011. All regions that meet the requirements of the state may set up a system of VAT refund on consumer goods with a value of more than CNY500 (approximately US\$80) for foreign visitors (including citizens from Taiwan, Hong Kong and Macau) who stay in China less than 183 days. The refund claim will need to be filed within 90 days of purchasing the goods.

The refund rate is 11% of the amount stated on the invoice, including VAT. The current rate of VAT in China is 17%. If the refund exceeds CNY10,000 (approximately US\$1,610), the refund will be remitted only to the bank account of the visitor and cannot be paid in cash.

The implementation of this policy is intended to boost tourism to China and to adopt a similar practice that has been adopted in other countries.

Europe

European Union – EU Finance Ministers issue statement on renewed commitment to implement EU financial transaction tax

Executive summary

On 27 January 2015, the Finance Ministers of Austria, Belgium, Estonia, France, Germany, Italy, Portugal, Slovakia, Slovenia and Spain issued a joint statement (the Statement) setting out their renewed commitment to agree on a directive implementing a financial transaction tax at the European Union level (EU FTT). Greece, which has been one of the participating Member States (PMS), did not sign the Statement given the recent elections.

The Statement indicates a departure from the approach outlined in the joint statement issued by 10 of the PMS on 6 May 2014 (the May 2014 Joint Statement), which contemplated introducing a first stage of EU FTT confined to shares and “some derivatives.” By contrast, the Statement notes that the EU FTT should be taxed on the widest possible base and at low rates.

The Statement reflects a desire of certain PMS to restart EU FTT discussions in view of the PMS’ failure to reach substantive agreement on the form of an EU FTT by the end of 2014 (which had been the target noted in the May 2014 Joint Statement).

In particular, the Statement mirrors the views expressed by the Finance Ministers of France and Austria in their joint letter dated 21 January 2015 sent to the Finance Ministers of the other PMS before the ECOFIN meeting of 27 January 2015 (the Letter).

Detailed discussion

Key points covered in the Statement

The Statement covers the following points in relation to the EU FTT proposal:

- ▶ **Signatories.** Ten of the PMS confirmed their renewed commitment to reach an agreement on the EU FTT proposal.

- ▶ **Scope.** The PMS have decided that the tax should be based on the widest possible base and low rates. The Statement notes that full consideration should be given to the impact of such a tax on the real economy and the risk of relocation of the financial sector.
- ▶ **Timing.** The PMS reiterated their “willingness to create the conditions necessary” to implement the EU FTT on 1 January 2016.
- ▶ **Impact on non-participating Member States.** The PMS say they will fully respect the principles of transparency regarding non-PMS required by the Treaties of the European Union while pursuing the negotiations.
- ▶ **Procedure.** The PMS have decided to “streamline” procedures for the enhanced cooperation procedure and are looking for greater involvement of the European Commission in the enhanced cooperation work.
- ▶ **Next steps.** The PMS will report on progress at a future ECOFIN meeting.

In addition, based on newspaper reports, Austria will coordinate the political talks and Portugal will coordinate the technical work. This seeks to address the coordination concern noted by the French and Austrian Finance Ministers in the Letter.

While the Statement itself is silent on the definitions of “widest possible base” and “low rates,” an article posted on the official website of the Austrian Federal Ministry of Finance indicates that “a lower rate of tax than originally planned is also conceivable.” (The draft EU FTT directive published by the European Commission on 14 February 2013 proposed minimum tax rates of 0.1% for equities and bonds and 0.01% for derivatives.)



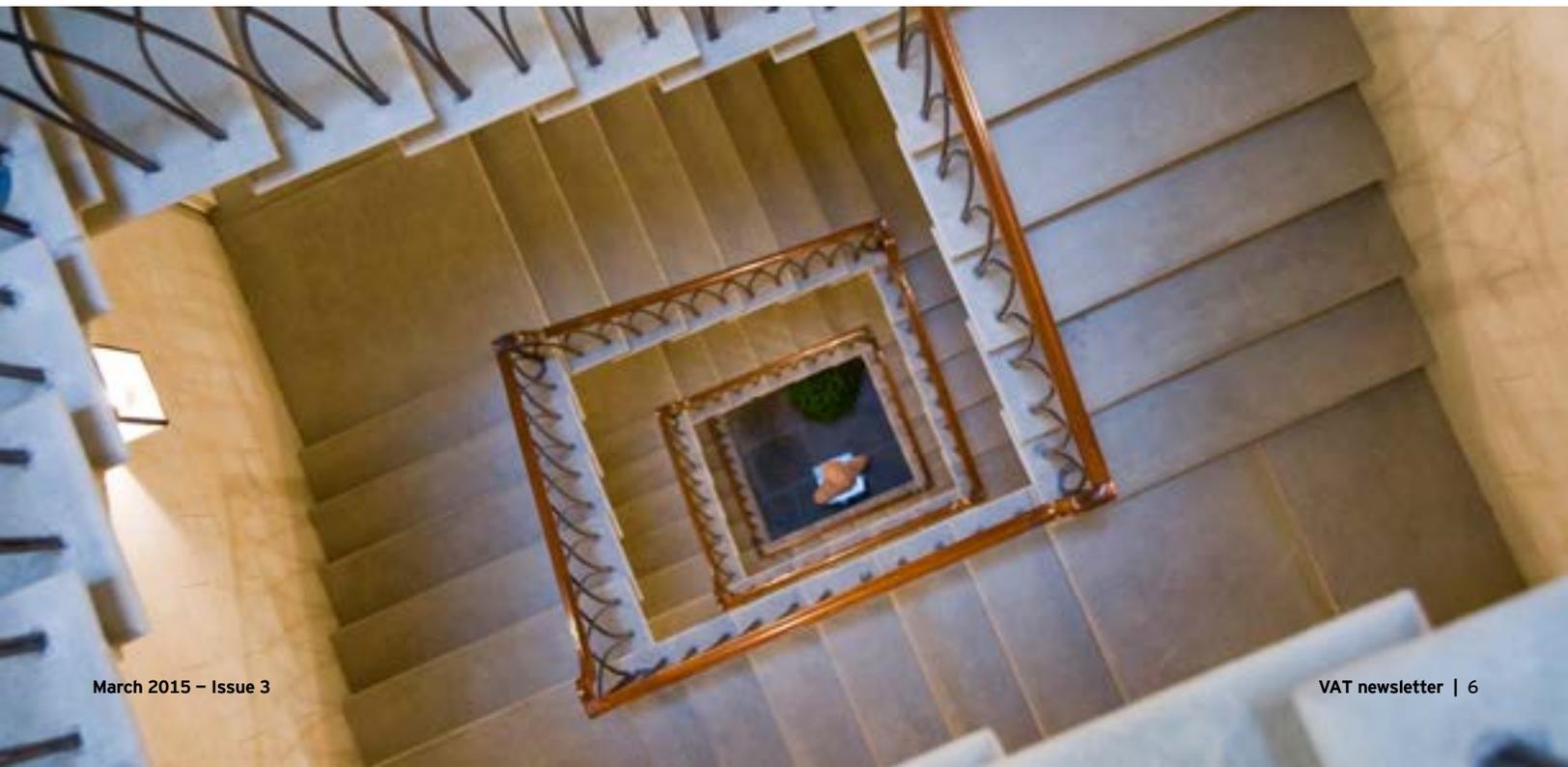
There are a number of observations to make with regard to the Statement's content, as well as on those issues it does not address:

- ▶ **Basis of tax.** The Statement does not clarify the basis on which the tax will apply, i.e., whether the tax will be based on all or some of the issuance or residence or counterparty principles. However, the reference to the risk of relocation of the financial sector may reflect concerns that have been expressed, particularly in relation to an FTT based on the counterparty principle. This remains to be clarified.
- ▶ **Have the PMS now been reduced to 10 Member States?** The Statement has been signed by only 10 countries. Greece (previously included as a PMS) has not signed the Statement. While the news has reported that Greece did not sign the Statement because of the recently held elections and therefore had no representative to agree to the Statement, it is yet to be confirmed whether the new Greek Government will retain the position adopted by the outgoing Greek Government. It is also notable that Slovenia, which did not sign the May 2014 Joint Statement (leading to speculation that it had dropped out of the enhanced cooperation process), has signed the Statement indicating that it remains in the process. A minimum of nine Member States are required for a legally valid enhanced cooperation procedure.
- ▶ **Scope.** As noted earlier, the Statement does not elaborate on the definition of "widest possible base." In particular, it is unclear whether this is simply a political statement of intent or a clear decision to move back toward the European Commission's proposal of 14 February 2013, which sought to apply EU FTT to "all instruments" (i.e., equities, bonds and derivatives). The article posted on the official website of the Austrian Federal Ministry of Finance excludes government bonds from the scope of taxation. This is arguably a significant departure from the

2014 discussions, where only equities and "some derivatives" were being considered as initial focus areas. Notably, this broad-based approach was opposed by France, which appears to have recently shifted its position. This development may itself have contributed significantly to the new impetus for advancing EU FTT discussions.

However, given that the PMS are conscious about the risk of relocation in the financial sector and have agreed to give full consideration to the impacts on the real economy, this leaves open a very wide range of options in the scope and design of the tax.

- ▶ **Timetable.** A start date of 1 January 2016 as stated in the Statement appears ambitious, given that (a) the Statement is essentially a political statement, and there is a need to reach agreement among the PMS and flesh out both high-level and detailed technical rules and finalize the form of a Directive; (b) sufficient time is needed to complete the EU legislative process, allowing the PMS time to transpose the Directive into national laws (which would typically be at least six months from the date the Directive is passed into EU law); and (c) sufficient lead time is needed for financial market participants to build the requisite systems to ensure collection and payment of EU FTT. The Austrian Finance Minister and German Finance Minister have agreed on a timetable for the tax that places a stock-exchange levy on equities from 2016 and tax on other transactions from 2017. With regard to this timetable, in EY's report to the European Commission on EU FTT collection (see the European Commission website for a copy of the report [here](#)), the point was made that the implementation of a wide-scale EU FTT should be more akin to the timetable for a major market reform, like MiFID II (the EU Directive on markets in financial instruments), rather than a relatively simple financial transaction tax like the French Financial Transaction Tax – as in, years rather than months.





- ▶ **Exemptions.** The Statement does not state the position of the PMS on exemptions from EU FTT, which has been a key concern for the financial markets. This concern was reiterated in the joint letter written by the European banking sector (European Association of Cooperative Banks (EACB), the European Association of Public Banks (EAPB), the European Banking Federation (EBF) and the European Savings and Retail Banking Group (ESBG)) to EU Finance Ministers. The article posted on the official website of the Austrian Federal Ministry of Finance only references government bonds as excluded from the scope of taxation.
- ▶ **Sharing of EU FTT revenues among the PMS.** One of the most important reasons for the breakdown in the EU FTT talks last year was whether the tax collected in smaller countries would be sufficient to compensate for the cost of collecting. The Statement does not make any reference to this.

The UK's legal challenge

It is also important to note that any revised EU FTT proposal must take account of the obligations under EU law for the PMS to avoid causing a negative impact on the Single Market or on obligations, rights and competencies of non-PMS. Against this backdrop, it should be remembered that the UK has already challenged the legality of the EU FTT enhanced cooperation procedure before the Court of Justice of the European Union (CJEU), and while the CJEU rejected that challenge as “premature” and speculative, the CJEU equally made it clear that the UK would be

able to renew its challenge to the EU FTT as and when a final proposal was adopted.

It is possible that other Member States could join a further UK challenge to the EU FTT if one were to be launched.

Next steps

The PMS have not yet publicly outlined any timetable for future discussions. However, it is fully expected that there will be intensive discussions, at both the political and technical levels.

Implications

The renewed Statement indicates a refreshed desire to proceed, and therefore financial institutions and others affected should continue to watch developments closely.

In the meantime, financial institutions should ensure that their processes are robust with regard to their obligations under the domestic French and Italian financial transaction taxes, and (to the extent they have not already done so) give further consideration to what they need to do in order to ensure compliance with an EU FTT if that comes about.

Financial institutions and other affected parties should also continue to make strong representations to government stakeholders about the impact of an EU FTT proposal, particularly due to the difficult economic environment in Europe.



European Commission – Study on the economic effects of the current VAT rules for passenger transport

The European Commission has published a study on the economic effects of the current VAT rules for passenger transport as well as possible options for reform.

The current VAT rules for passenger transport services can create distortions of competition, notably owing to differences among Member States in the application of VAT exemption, or reduced rates. Even where exemptions or reduced rates do not apply, the complexity of the current VAT “place of supply” rules increases compliance costs and may cause voluntary, or involuntary, non-compliance. These impacts are greater for passenger transport than most other economic activities because of the international nature of many of the services provided. This study contributes to the debate on possible options for reform by providing a summary of the current state of the passenger transport market, a review of the current VAT regime, an assessment of the impact of many of the perceived distortions and an evaluation of some of the alternative VAT structures on which a future, improved VAT regime for the passenger transport sector might be based.

The study can be accessed by clicking [here](#).

France and Luxembourg – CJEU judgment: the VAT liability of supplies of electronic books

The Court of Justice of the European Union (CJEU) recently handed down its judgment concerning the reduced rate of VAT applied to electronic books (e-books) in France and Luxembourg.

The CJEU held that e-books should be subject to the standard rate of VAT on the basis that e-books are electronically supplied services.

Businesses in the publishing and e-commerce sectors and other entities making supplies that benefit from a reduced rate of VAT on e-books in EU Member States may wish to consider the implications of the judgment further.

Background

Books have traditionally been subject to reduced VAT rates in almost all the EU Member States.

According to the EU VAT Directive, Member States may apply a reduced VAT rate to the supply of books on “...all physical means of support” (as amended in 2009 by Directive 2009/47/EC).

The evolution of technology has, however, allowed for the development of the supply of books in formats other than paper (e.g., CDs, DVDs, cards and digital e-books available as downloads via the internet).

The development of these new means of supplying books has given rise to debate regarding the applicable VAT treatment, particularly

with regard to the interpretation of “all physical means of support.” Questions have therefore inevitably arisen as to whether the reduced VAT rate applicable to paper books should also be applied to audiobooks and e-books.

The uncertainties with regard to the applicable VAT rate on books have already led the CJEU to provide guidance on the VAT liability of books supplied on other physical formats. In the *K Oy (C-219/13)* judgment, released on 11 September 2014, the CJEU held that national legislation that applies different VAT rates to printed books and books supplied on other physical media is compatible with EU law, provided that the principle of fiscal neutrality is upheld. If, on the other hand, the customer believes that the purchase is of a book, regardless of the medium upon which it is delivered, then the comparable reduced rate should apply.

The question regarding the VAT rate applicable to e-books, raised in the current case, is connected to that already submitted to the CJEU in the *K Oy* case, but has slightly different legal grounds. For VAT purposes, e-books fall to be treated as electronically supplied services. According to the EU VAT Directive, reduced VAT rates may not be applied to electronically supplied services.

Despite this, France and Luxembourg equalized the treatment of printed books and e-books applying super-reduced VAT rates (3% in Luxembourg and 5.5% in France as from January 2013) to both, on the grounds that e-books and books are similar goods and therefore should enjoy similar VAT treatment. The European Commission disagreed with by France and Luxembourg and launched formal infringement proceedings.

The CJEU judgment

The CJEU has held that e-books should be subject to the standard rate of VAT, on the basis that e-books are electronically supplied services. Affected businesses may wish to consider the implications of the judgment without delay.

Implications

Recently, Member States such as Italy and Malta have followed France and Luxembourg in applying the reduced VAT rate to the supply of e-books. In addition, since 1 January 2015, business-to-consumer (B2C) supplies of e-books are subject to VAT where the consumer is resident.

Businesses supplying e-books in Member States that have adopted reduced rates, or making supplies of e-books cross-border to such countries, should consider the implications of the judgment.

Specifically, ERP systems will need to be updated to ensure that VAT is accounted for correctly on a prospective basis. The retrospective implications of the judgment should also be further considered, and corrective action should be taken where appropriate.



Middle East, India and Africa

South Africa – Tax authorities increase scrutiny of retrospective transfer pricing adjustments

In relation to sales between unconnected parties, the South African Customs legislation provides that the value for customs duty calculation purposes is the transaction value, i.e., the price actually paid or payable by a purchaser to a seller (the invoice price). If the invoice price of goods changes or is amended later, an importer is obliged to amend its original entry with the South African Revenue Service (SARS) as well as pay additional customs duties and value-added tax (VAT) over to SARS.

A retrospective transfer pricing (TP) adjustment – i.e., an amendment to the cost of imported inventory, either through a debit (downward) or credit (upwards) note, with a view to ensuring that a limited risk distributor's operating margin falls within that prescribed by the TP policy – has a corresponding impact on the transaction value of imported goods. In this case, the seller is required to issue an amended invoice to the importer. The importer is equally obliged to, within a month of receiving the amended invoice, produce the same to SARS (i.e., amend their original declarations and pay the customs duties/VAT over to SARS).

Failure to declare such adjustments is an offense and may result in interest and penalties (i.e., the greater of a fine not exceeding ZAR40,000 or treble the value of the goods to which the statement or document relates). An importer's entitlement to claim back customs duties originally paid (in instances where a debit note was issued) will be lost on failure to adhere to the month's notification requirement.

In August 2012, SARS issued a communication with the following guidance:

- ▶ Informed importers of their obligation under the customs legislation to report the adjustments to SARS.
- ▶ Advised that the non-declaration of retrospective transfer pricing adjustments to Customs is a risk.
- ▶ Implicitly extended the prescription period to five years (and not the two years per the Customs legislation). It would seem that the extension of the prescription period by SARS can be successfully challenged as it is not supported by legislation (except in instances where SARS is able to prove intention by the importer to defraud).

It is important to note that the fact that the goods in question are not subject to customs duties does not exonerate an importer from this legislative obligation.

SARS has confirmed that the respective communication was sent to all affected importers registered with SARS. However, it appears that many multinationals are not aware of this obligation and therefore are not communicating the retrospective adjustments to SARS (inclusive of potentially underpaid customs duties and VAT). It is important for companies to be aware of this as SARS is increasing scrutiny of retrospective transfer pricing adjustments. As noted, such adjustments could result in significant penalties.

Also, retrospective transfer pricing adjustments will have an impact on the customs part of the IT14SD (Company Income Tax Supplementary Declaration) as it affects a company's cost of sale.



EY newsletters and alerts

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

Canada: Tax Alert – QST Compliance Requirements – investment plan managers.

Canada: Tax Alert – Invoices of Accommodation.

Canada: Tax Alert – Changes in Customs policy on transfer pricing downward adjustments.

Czech Republic: *EY Tax News*, February 2015: Ernst & Young s.r.o. has issued the latest edition of its client tax newsletter.

Hungary: Extension to trial period for EKAER system for transported goods: Hungary is introducing new regulations and reporting requirements in respect of transported goods – the EKAER system.

India: Budget 2015 – GST developments: The Union Budget (28 February 2015) has reiterated the government's position that GST will be implemented in April 2016. We can provide details of the Ernst & Young LLP (India) Budget webcast and a copy of the Ernst & Young LLP (India) Budget Booklet.

Netherlands: *Tax Update Weekly*, edition 7, 2015, and edition 8, 2015. Weekly e-newsletter regarding latest update of the most recent and relevant tax news from the Netherlands and the rest of the world.

Poland: Storage of purchase invoices in electronic format: It is now possible to store purchase invoices electronically in Poland.

Puerto Rico: Tax Alert – Puerto Rico Governor introduces VAT bill to Legislative Assembly.

Slovenia: *EY Tax News*, February 2015.

Sweden: Tax Alert – Changes to reporting of import VAT.

UK: *VAT News* – weeks ending 9 February 2015, 25 February 2015 and 2 March 2015. Weekly client e-newsletter round-up of VAT news from the UK, the EU and other countries.

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