

## NEW COMPLIANCE REQUIREMENTS – CONSEQUENCES OF THE VAT PACKAGE

### Major changes to VAT rules effective 01.01.2010

**On December 29, 2006, the Luxembourg VAT authorities issued circular nr. 723 relating to the European Court of Justice Cases involving “BBL” and “Abbey National” stating that investment vehicles listed in article 44 1 d of the Luxembourg VAT laws have to be considered as taxable persons for VAT purposes. The circular was revolutionary in the Luxembourg approach to VAT as prior to implementation of this circular, investment funds were considered as non VAT payers and having no obligations with respect to VAT compliance.**

Life has changed and now these vehicles have been required to register for VAT in order to comply with their VAT obligations. In this context, the first round of annual VAT returns have been completed this year listing services received from non Luxembourg suppliers which are not VAT exempt and which are covered by the reverse charge mechanism. Those services are typically of an intellectual nature, for example lawyers' fees incurred in the set-up of the relevant vehicle or other specific consulting services.

However across the EU, other important VAT changes are emerging. The first one is the famous VAT package adopted at the end of December 2007 and the second is probably the proposal for a Directive regarding financial and insurance services although at the time of writing no definitive proposal as to the Directive's contents is available.

The VAT package adopted by ECOFIN will introduce the most fundamental changes to the VAT system since 1993.

To summarize, the key changes involve:

- A change in the place of supply rules which in future will be determined by reference to where the customer rather than the supplier is located. This change takes effect from January 1, 2010.
- A new obligation to complete an Electronic Sales Listing report regarding the supply of cross border services. This change also takes effect from January 1, 2010.
- Electronic VAT refunds improving the timing and efficiency in the VAT refunds.
- Changes to the place of supply rules for services supplied electronically. This change will take effect in 2015.

This article focuses on the practical issues resulting from the first two changes mentioned above as they will generate major change for the finance industry.

#### CHANGE TO THE PLACE OF SUPPLY AND REPORTING RULES

The changes regarding the place of supply and the additional reporting obligation without doubt crystallize the most fundamental changes to EU VAT requirements.

It is quite clear that the present rules governing the place of supply of services are too complicated such that the VAT payer can never be completely confident as to the correct application of the applicable VAT rules on the supply of cross border services. For example, publication fees for investment funds, what is the current correct VAT treatment? Based on our experience we have seen some EU countries apply the general rule (taxation in the country where the supplier is established) even though the Luxembourg investment fund is VAT registered. In that case foreign VAT is charged to the fund. Other service suppliers apply the reverse charge mech-

anism. These different approaches create uncertainty and in the worst case scenario could result in double taxation for the VAT payer i.e. the recipient of the services concerned.

However, now the VAT logic will be reversed and will have to be integrated into business processes.

In addition, the requirement to report a summary statement (so-called “EC sales listing”) for services to which the new general rule of reverse charge applies suggests that the IT system of the relevant business owner (supplier of the service) must be capable of capturing the information necessary to complete the statement. At the same time this data has to correspond to the data reported by the recipient of the service to avoid any discrepancies which could result in a different VAT treatment.

While this system may be familiar to the commercial industry due to obligations to establish an EC sales listing regarding the cross border intra-community sales of goods it is different for the financial industry.

In the financial sector, many accounting systems would have to be adapted to produce the required reports. Indeed until now, the reporting of this information has never been required in such a prescribed manner and it is quite certain that it will be very difficult to obtain the information if appropriate steps are not taken.

While the production of multiple reports might yield the information required, neither the inherent risk of inaccuracy nor the disproportionate amount of time which will be involved in collection of the required information can be ignored in such an approach. In addition, it will almost certainly be necessary to rigorously train people involved in this business process with respect to VAT and the related accounting requirements. Under the proposed Direc-

tive the recipients of services would be required to complete monthly VAT listings, detailing the value of reverse charge services purchased in the EU.

The details which would have to be provided in these listings are not yet precisely defined. However the proposal suggests that the report would include invoice-level data for all suppliers and not just a summary of the transactions. However, what is certain is that these rules will take effect from January 2010.

At this stage it is still quite unclear whether the listing should also disclose VAT exempt supplies, i.e. the totality of the cross-border transactions or whether only taxable supplies which are not covered by a VAT exemption in the country of the recipient should be declared.

The first approach, i.e. that any cross border supplies would have to be reported, would have the advantage that the guideline is quite easy to understand in the sense that a detailed knowledge of the VAT legislation and the possible VAT exemptions would not be required.

The second approach, that the report would only include services to which the reverse charge mechanism applies in the recipient's EU country would require that the supplier has to be familiar with the reverse charge mechanism, in particular with the respective provisions in the Member States into which he provides services.

This system will be very complicated and will probably generate discrepancies in practice which will have to be reconciled.

For example a supplier located in EU Member State A provides investment advisory services to a securitization vehicle covered by the VAT exemption in Luxembourg. Should these services be mentioned in the EC sales listing? Under its own VAT rules probably yes but under the Luxembourg VAT rules, no.

Additional difficulties which may arise are the consequences of any discrepancies detected by the cross-border EU system put in place by the EU Member States. This system will either be similar to the present system VIES or form part of the existing VIES system of exchange of information between Member States.

Parallel to the current situation existing for intra – community cross border transactions on goods, the supplier and the recipient of the service(s) will probably be asked

to reconcile differences found by the system. Consequently, the business process of the supplier and the recipient should prepare for this eventuality and include features to ensure accurate compliance and appropriate information.

As already mentioned, based on the proposal of the Council Directive, monthly reports would have to be completed when the VAT payer acquires intracommunity deliveries of goods or services covered by the reverse charge for a total amount exceeding €200 000 per year. Fortunately, if the VAT payer does not exceed that threshold, Member States may reduce the frequency to quarterly or, at a minimum, annual reporting.

These additional compliance requirements and the associated short time frame for implementation should not in principle create huge problems for the commercial industry, for which the requirement to report statistics is nothing new as EC sales listings of goods are presently filed on a quarterly basis. However, as mentioned previously the situation is different for the financial sector and probably more problematic again for the investment fund industry. We observe that VAT compliance reporting is something which is very new for this sector, considering that until now, VAT registered investment funds only had to file a simplified VAT return on a yearly basis. Indeed when circular 723 was implemented, the Luxembourg VAT authorities denied Luxembourg investment funds the right to recover input VAT (paid or declared). Even if this approach might be questionable based on the EU VAT directive, in most cases it has the undeniable advantage of relieving the investment fund industry from the administrative burden of filing monthly and annual VAT returns.

Does this mean that the VAT package and related EC sales listing requirements would result de facto in a switch to a monthly process with a significant effort in time and resources to comply with this new obligation?

No definitive answer can be given for the time being.

But what is certain is that we have just less than 12 months until these changes come into effect to adapt accounting and IT systems, design the solutions, test the modifications across the system to be ready to deal with those practical issues

and challenges. If the business process is not adapted in time, the VAT package and related additional VAT requirements could be problematic for the financial sector.

### SUMMARY

The VAT environment for the investment industry has significantly changed since April 1, 2007. Not only in that investment vehicles now qualify as taxable persons and are liable to pay VAT on services or goods received under the reverse charge mechanism, but also in that the compliance requirements of the VAT package might lead to additional administrative and organisational challenges.

Thus, companies in the investment industry should verify in the first place whether they receive services from abroad and, if so, whether the new rules of the VAT package might impact the current VAT treatment. Insofar as the current VAT treatment is not affected by the new rules, it seems advisable to ensure that all information required regarding the compliance obligations are made available from accounting systems. Generally speaking, the accounting processes should reflect all relevant information at the invoice level (i.e. name of supplier, identification number, and amount invoiced...) for services received under the reverse charge mechanism and account for VAT.

Given the recent inclusion of investment funds among the VAT payers and the additional reporting requirements, more time and effort will be required to evidence the accuracy and completeness of the numbers in VAT returns and financial statements. ■

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