Indirect Tax developments in Europe and LATAM

European Union
European Commission (‘EC’)
EC’s consultation on modernizing VAT for cross-border e-commerce

The EC has recently launched a public consultation to help identify ways to simplify the application of VAT in the context of EU cross-border e-commerce. The EC is seeking comments from businesses and other interested parties prior to drafting legislative proposals in 2016 as part of its Digital Single Market Strategy. The consultation will run for 12 weeks and will end on December 18, 2015. Interested parties can access the survey that is available on the Europa website.

Court of Justice of the European Union (‘CJEU’)
CJEU judgment on input VAT recovery (Sveda UAB: C-126/14)

The CJEU reaffirmed that, when costs are used for the purposes of transactions that are exempt from VAT, or for purposes with no link to any economic activity, VAT cannot be deducted by a taxpayer.

A Lithuanian organization (Taxpayer’) operates a tourism-related business. Its activities consist of providing accommodation, food and beverages and organizing trade fairs, conferences and leisure activities. The Taxpayer incurred VAT on costs associated
with constructing a recreational trail. The construction costs were 90% funded by the Ministry of Agriculture (MoA) under the terms of an agreement that also provided that the Taxpayer would grant visitors access, free of charge, for a period of at least five years post-construction. As a result, the tax authority decided that the Taxpayer was not entitled to recover the VAT incurred on the capital cost of construction on the basis that there was no direct and immediate link between the construction costs and the Taxpayer’s taxable tourism activities. The Taxpayer disagreed on the basis that the path was intended to attract visitors to their premises where they would ultimately provide the visitors with taxable tourism related goods and services for consideration (e.g., souvenirs, food, drink, access to attractions, etc.).

The Lithuanian court decided to refer the question to the CJEU to determine which particulars of the EU VAT legislation 1 can be interpreted as granting a taxpayer VAT recovery entitlement on capital costs incurred to produce an item for a business purpose when such an item is used by members of the public, free of charge, but may also be recognized as a means for attracting visitors to a location where the taxpayer can supply taxable goods and services for consideration. In its decision, the CJEU reaffirmed that, when costs are used for the purposes of transactions that are exempt from VAT, or for purposes with no link to any economic activity, VAT cannot be deducted by a taxpayer. In both cases, the direct and immediate link between the expenditure on purchases and the economic activities subsequently carried out was severed. However, in this case, making the recreational trail available to the public, free of charge, was not covered by any VAT exemption. In addition, as the expenditure incurred could be linked to the Taxpayer’s planned tourism-related economic activity, it did not relate to activities outside the scope of VAT. Consequently, the immediate use of the recreational trail, free of charge, did not affect the existence of the direct and immediate link with the Taxpayer’s economic activities and should consequently have no effect on its right to VAT recovery.

Therefore, the CJEU ruled that a taxable person should have the right to deduct VAT incurred on the acquisition or production of capital goods, for the purposes of a planned economic activity related to rural and recreational tourism, which are (i) directly intended for use by the public free of charge, and (ii) may enable taxable transactions to be carried out, provided that a direct and immediate link is established between the expenses associated with the input transactions and an output taxable transactions.

**Europe**

**UK**

**HMRC’s views on VAT grouping following Skandia**

Her Majesty’s Revenue and Customs (HMRC) has recently confirmed the UK VAT changes resulting from the CJEU’s judgment in *Skandia America Corporation USA* (see VAT News issue 19) and provided details of which other European Member States operate ‘establishment only’ VAT grouping provisions.

In summary, an overseas establishment of a UK-established entity will, beginning January 1, 2016, be treated as part of a separate taxable person if the overseas establishment is VAT grouped in a Member State that operates similar ‘establishment only’ grouping provisions to those in Sweden that were considered in *Skandia*. This treatment will apply whether or not the entity in the UK is part of a UK VAT group. Therefore, businesses must treat intra-entity services provided to or by such overseas establishments as supplies made to or by another taxable person and account for VAT accordingly.

HMRC currently expects the changes to apply to Belgium, the Czech Republic, Denmark, Estonia, Hungary, Latvia, Slovakia, Spain and Sweden. The position in Cyprus, Finland, Germany and the Netherlands is not yet clear. Businesses

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established as a UK branch or head office, that receive supplies from their own establishment in the EU, should consider the UK VAT treatment of such acquisitions when the EU establishment is a member of an ‘establishment only’ VAT group in one of the aforementioned nine EU Member States.

**HMRC updates pro-forma MOSS returns**

HMRC has recently published updated versions of its pro-forma Mini One Stop Shop (MOSS) returns which can be used by businesses to declare VAT due in other Member States on B2C supplies of telecommunications, broadcasting and electronic services. The pro-forma returns can be uploaded to HMRC’s online services website to form part of a MOSS declaration and include guidance notes on completing and submitting the declarations.

**Sweden**

*Abolition of certain aspects of the ‘slussning’ VAT recovery relief*

According to a proposal from the Swedish government, the regulations on the ‘slussning’ will be abolished as of January 1, 2016. Currently, when an entity supplies another company with VAT exempt goods or services, the vendor is not entitled to VAT recovery on costs associated with its VAT exempt activities. However, under the ‘slussning’ VAT relief, when both entities are part of the same corporate group, the receiving entity is permitted to deduct the VAT incurred by the vendor provided this entity performs VAT taxable activities. The government has concluded that such a system is not compatible with EU law. Since the system is not covered by the Swedish regulations on VAT grouping, abolition of the ‘slussning’ will result in non-deductible input VAT related to exempt services supplied between members of a corporate group. Businesses that currently take advantage of the ‘slussning’ VAT relief should consider the impact of this proposal on the group’s VAT recovery position.

**Denmark**

*Proposal to allow Danish Tax Authorities to request payment information in connection with internet sales by foreign vendors to private individuals in Denmark*

In a recent proposal, the Danish Government seeks to broaden the tax authorities’ information collection powers by enabling it to request payment information in connection with foreign suppliers of goods, or electronic services, to private individuals established in Denmark. The intention behind the proposal is to protect the Danish VAT tax base and ensure that Danish companies are able to compete on pricing with their foreign counterparts. The proposal also aims to minimize VAT leakage.

This new proposal authorizes the tax authorities to request information from providers of payment solutions (e.g., credit card companies, banks, etc.). The information requested from the payment service provider includes the total amount received by the foreign vendor in relation to sales to private individuals in Denmark. The information received is intended to help the tax authorities determine whether the foreign supplier should be registered for VAT in Denmark. If accepted by Parliament, the new proposal is expected to apply effective January 1, 2016. Non-established businesses engaged in the supply of goods and/or services to Danish private customers, which are not currently registered for VAT in Denmark, should review their VAT position closely and consider whether they should be registered for VAT under Danish VAT law.
Italy

Proposed changes to VAT bankruptcy procedures

The draft of the ‘Stability Law’ for 2016 would significantly change the conditions for amending the taxable base and associated VAT, via the issuance of a credit note, in the case of bankruptcy procedures. Under the current legislation, in case of an insolvent customer, the supplier is required to wait until the end of the bankruptcy proceedings to issue a credit note to recover any VAT initially charged. If approved, the new law would allow the supplier to anticipate the recovery of VAT initially charged and not collected when the bankruptcy procedures officially commence. The proposed changes should introduce greater certainty regarding VAT recovery for taxpayers. The draft law is due to be discussed by Parliament over the next few weeks and the final version should be approved before the end of 2015. We will keep you updated on further developments.

Americas

Brazil

Change in application of ICMS on interstate sales of goods to non-ICMS taxpayers

As a general rule, ICMS (commonly referred to as State VAT) is typically charged on the supply of goods at the rate applicable in the state in which the vendor is located (known as the internal rate). Special (lower) rates of ICMS can apply to interstate sales (known as the interstate rate) depending on the location of the supplier and client and whether the goods are imported or domestically sourced.

When the acquirer of goods is a non-ICMS taxpayer (e.g., private individuals), the ‘internal rate’ of ICMS (i.e., the rate applicable in the state in which the vendor is located) is applied, irrespective of whether the transaction involves parties located in the same state or not. Certain, less developed, states have argued the reasonableness of this rule in the last few years as such states are not entitled to receive such revenue when private individuals are located in their states and are purchasing goods, via e-commerce and telecommunication platforms, from vendors located in other states.

As a result, the rules applicable to interstate transactions, when the recipient is a non-ICMS taxpayer, will be amended effective January 1, 2016. Under these new rules, interstate rates of ICMS (7% or 12% depending on the location of the vendor and the recipient) will be applicable to such transactions. In addition, the difference between the internal and the interstate rates will be shared between the selling and receiving states as follows:

- 2016 – 40% to the destination state and 60% to the origin state
- 2017 – 60% to the destination state and 40% to the origin state
- 2018 – 80% to the destination state and 20% to the origin state
- 2019 onwards – 100% to the destination state.

With regard to the above rates, it is important to note that the initial intention of the law change was to limit its application to interstate transactions performed via e-commerce and telemarketing channels. However, in practice, the law change will apply to all interstate transactions involving non-ICMS taxpayers and not only those performed via e-commerce or telemarketing channels. Businesses who are engaged in such interstate transactions in Brazil should consider the impact of these new rules on their current ICMS position.

ICMS tax base for transactions involving the sale of standard software within São Paulo State

In accordance with local legislation in Sao Paulo, customized or modified software is considered a service and is subject to ISS (Municipal services tax). Standard software
(i.e., a turnkey software solution), sold on a large scale, is considered a good and as such, is subject to ICMS (State VAT) at the relevant rate.

Within the state of Sao Paulo, the taxable base upon which ICMS is charged on the standard sale of software is considered to be double the memory size of the medium through which the software is supplied. As a result, when software is downloaded electronically the ICMS base is currently zero (i.e., when the software is not supplied on a medium such as a CD or a DVD).

The recently published Decree (61,522/2015) confirms that, effective January 1, 2016, the taxable base upon which ICMS will be charged will be the value of the software itself. As a result, all standard software will be subject to ICMS, irrespective of whether it is supplied through a medium or electronically.

Under the current regime, many Brazilian companies within the software industry are not assessing ICMS on their standard software transactions given the minimal tax base. However, effective January 1, 2016, the taxable base upon which ICMS is due may substantially increase. As a result, companies in the business of purchasing or selling standard software in the Sao Paulo State should consider the impact of the change in the ICMS tax base on their pricing structure and their billing systems.

**IPI on resale of imported products**

As a general rule, IPI (i.e., Excise Tax in Brazil) is imposed on the import of goods. Also, as a general rule, importers are required to collect IPI on the resale of the imported products.

The taxation of the resale of imported products for IPI purposes became a controversial matter in Brazil. Many companies started to litigate this treatment arguing that IPI should not be imposed on such resale transactions. After granting favorable decisions to Brazilian taxpayers in certain cases involving this matter, the Brazilian Superior Court of Justice recently issued an unfavorable decision on a case involving this matter. As a result of this recent decision, companies that do not currently calculate IPI on such resale transactions should consider the impact of the new decision on their activities.
Let’s talk
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