Part A

Question 1

From: Tax Consultant
Estoria

To: Mr. Alexander Pappas
Green Gaia Ltd (GG)

Anywhere, DD/MM/YYYY

Subject: Green Gaia's operations and their VAT implications

Dear Alexander,

Thank you for reaching out to our firm. We are delighted to present you with some guidance regarding the VAT implications of your operations in the EU. We have organized our answer in several paragraphs for clarity.

Establishment in the EU

A supply should normally be allocated to the right fixed establishment of the taxable person. A fixed establishment would typically require a certain degree of permanence, and human and technical resources to be considered as receiving a supply or being in a position to make one as evidenced by ample case law from the Court of Justice of the European Union (CJEU), refers Berkholz and Welmory in particular. This is however more a provision that allows Member States to correct abnormal situations. The fact that yourself and two other directors based in Estora will hold meetings in Estoria from a rented office (it would not change anything it were owned) in Estora alongside 5 local employees should address the human and technical resource requirement. The board directors in particular, provided that they are more than rubberstampers, should create a decision-making centre in Estoria. However, special care will have to be taken that the nature of activities undertaken there is not of a purely clerical nature; the drafting of reports, which would be the core activity of your company, should help to achieve a fixed establishment in Estoria - unlike other activities that seem more administrative in nature. Should it not be the case, fallback provisions could mean that your main establishment in the United States would be considered to have made/received supplies, but it should not be the case here. The VAT number of the Estoran establishment would have to be used in procuring supplies/receiving services (see later).

Taxable supplies and compliance requirements

GG would be supplying services to government agencies that are taxable persons registered in their respective countries (B2B services). Services invoiced to the Estorian taxable persons would be a domestic supply of services from GG. As such, GG would be issuing an invoice to such customers with Estorian VAT. It would therefore be required to register for VAT in Estoria since it is carrying out an economic activity there (art. 9 PVD). On the other hand, supplies of services to the government agencies in other EU Member States would fall under art. 44 of the Principal VAT Directive 2006/112/EC (PVD), which means that the customer would be liable to account for VAT. In practice, GG would have to issue a zero-rated invoice (art. 196 PVD) which would be subject to a reverse charge in the Member State where the customer is established. GG would have to include a relevant narrative on the invoice referring to the relevant provision of national law or art. 44 PVD (stating that it is subject to reverse charge) as well as a description of the services, and it should obtain the VAT number of the customer and ideally include it on the invoice after having checked it on the Europa website. It will further have to file recapitulative statements (Sales List) on at least a quarterly basis to report such cross-border services. On the face of its Estorian VAT return, it would also include these transactions in the relevant section. Such services would be exempt with credit due to the customer being liable for VAT.

Services from consultants to GG

Provided that GG is considered to be a fixed establishment that has capacity to receive the services from the United States - which would seem to be the case as per the first paragraph - it would mean that consultants based in the United States would be issuing a zero-rated invoice to GG. GG would then have to account for acquisition tax under the reverse charge mechanism. As it uses these services in the course of making taxable supplies, it will be able to claim input tax credits under art. 168 PVD. If other providers located in EU Member States are providing services to GG, they would do likewise and would need to obtain GG's VAT number (or establish that it is a taxable person by other means) in order to zero-rate their invoices.

Services from our firm

Concerning services from our firm, as we are based in Estoria, we would be invoicing GG (provided this is the arrangement in place under the letter of engagement, although economic substance would point to GG being the real recipient of the services), which would constitute a domestic supply of services on which Estorian VAT would be charged. You would be able to deduct our fees as long as they are considered overheads relating to your taxable activity. We assume that you have no other activities aside from the ones you mentioned, which would suggested you are fully taxable and can deduct VAT on input costs in full.

Training services

Training would generally constitute B2B services - it is different from the case where you would for instance organize seminars and control the right of admission, in which case you would charge VAT where the event took place. In this case, it would fall under the same rules as laid out before, requiring a zero-rated invoice to be issued to the customers who would then account for VAT under the reverse charge mechanism, provided the presentation of the invoice shows the correct narrative and recapitulative statements are filed (see paragraph 2). The fact that the clients' premises are used should not constitute a land supply as the service component of the transaction should override all other parts of the supply.

<u>Costs incurred by consultants for training services</u>

Hotel costs would usually incur VAT where the hotel is located as they are a land supply under art. 47 PVD and as per further guidance in Implementing Regulation 282/2011. Transport costs would likewise bear local VAT. Car hire, if kept below 30 days, the place of supply would generally be where the car was hired (triggering VAT there), if the duration of the contract exceeds 30 days, GG would be charged where it is established, i.e., in Estoria. All these costs are business related and should be deductible. However, if any expenses were not business-related (such as entertainment), they would be blocked and you would not be in a position to recover VAT on them (art. 176 PVD). As you are not liable to register for VAT in any of the countries where the training services are being supplied and to avoid multiple registrations, GG would need to claim input VAT incurred in these countries through the 8th Directive EU Refund Scheme. GG would most likely be eligible as you are not established in other countries and are only providing services that fall under the reverse charge mechanism. Under this scheme, you would have to file through the Estorian VAT portal an online claim that would include scanned invoices that have a value higher than EUR 1,000. The claim would have to be filed by 30 September of the following year. You would need to keep records for 10 years. The procedure does not take more than 8 months subject to any enquiries from the tax authorities.

We trust that the below addresses the points your raised. However, should you have any further questions, we would be delighted to help.

Question 2

From: VAT consultant
Boldonia

To: Finance Director
At: Blue Bridge Ltd (BB)
Boldonia

Boldonia, DD/MM/YYYY

Subject: VAT treatment of BB's transactions

Dear Finance Director,

We are delighted that you chose our firm to answer your requests in respect of VAT treatments relevant to your activities in the EU and are pleased to present you with a summary of these. For convenience's sake, we structured our answers in separate paragraphs to address each point on its own.

Forced sale of land

It is first to be noted that you had initially acquired the land in Estoria with a view to construct a refinery that would make taxable supplies. Art. 168 PVD enshrines the right to deduct VAT on input costs incurred in making taxable supplies. The CJEU usually takes a strict stance on such matters is a central EU law principle (fiscal neutrality) as only the final consumer should effectively bear the burden of VAT. The place of supply for land supplies (including construction costs) is where the land is located under art. 47 and IR 282/2011, which means Estoran VAT would apply. The sale of undeveloped land is usually exempt under art. 135 although an option to tax exists but this should not be relevant here as you incurred construction costs. There are two rulings from the CJEU that seem relevant here. The first one is Iberdrola whereby a company was renovating sewage at its own expense with a view to making taxable supplies (holiday accommodation), such preparatory work was considered to be deductible as the intention was clearly to make taxable supplies from the outset. It should likewise be possible for BB to evidence such intent and to encompass the preparatory work in what is deductible. Another relevant case is the Ghent Coal Terminal ruling wherey the Belgian tax authorities triggered a forced sale of the land and denied input tax deductions to the operator. However, the CJEU ruled that such denial was not valid as the intention to make taxable supply had never changed but rather the sale had been forced beyond the operator's control. BB's situation seems to be close to that case and it would bide well for your chances of recovering input VAT especially as there cannot be any grounds for unjust enrichment as you made a loss on the sale and would be doubly penalized by not recovering the input VAT incurred on construction costs.

Digital publishing activity

Such activities would be supplies of services and therefore constitute taxable activities for which input VAT deduction rights (for any costs incurred in connection with such supplies) would exist under art. 168. However, the situation is a bit blurred by the fact that no actual taxable supplies were made.

That does not necessarily preclude input tax recovery for the business owner to the extent the preparatory work with a view to making taxable supplies would be deductible if the link can be evidenced. Some case law has tended to consider that preparatory work in order to set up a company, pending an incorporation process, can validly be assigned to the company then incorporated, provided that such company should have been intended to make taxable supplies - an intent that would have to rest on objective factors. If the company subsequently makes taxable supplies, it should be possible to establish such a link. In which case, input tax on the expenditure incurred could be claimed. Depending on the status of the owner, she may have been a taxable person already and have had to deduct the VAT, in which case one way it could transferred to the company would be by way of a recharge invoice, although that would require more information.

Perhaps the case of a transfer of going concern situation (TOGC) whereby the business owner acts as transferor to a limited liability company (LLC) that becomes the successor should also be considered. If the Member State where the business owner is located allows for TOGC to be considered a non supply, then there might be grounds for the company to take over such expenses to the extent they were not already deducted by the business owner. However, that would assume that there are activities and assets that are being transferred together - if you could detail what type of expenditure was incurred by the owner - and that are capable of being operated in such a way as to be in a capacity to make taxable supplies (the relevant CJEU ruling would be X BV). If only expenses are being transferred without assets or a business in itself, it could be denied on the grounds this is not really a TOGC (as evidenced in the Mailat case where only the lease of the restaurant was transferred which was not enough to deem the operation to be a TOGC). That would also require the LLC to be VAT registered. The business owner would have had to be a taxable person, which she would have been under art. 9 PVD as there is no private capacity for an individual who carries out taxable activities (refers the Gavin Kostov case), so she should probably have registered for VAT as well and deduct in her own right.

Counterfeit trademarked goods

VAT applies to lawful and unlawful transactions without distinction as long as they are economic activities and in keeping with art. 2 and art. 9 PVD. The only instance where activities would be outside the scope of VAT would be where they were *illegal*. Sales of narcotics would for instance be illegal. This goes one step beyond the case at hand since the sale of trademarked goods is a legitimate activity. There was a CJEU case (R v Goodwin) that looks similar; in the case at hand, a company had been manufacturing counterfeit perfume and the CJEU held that its transactions should have been charged VAT. Not doing so would create distortions as it would mean that businesses that lawfully sold trademarked goods would be at a disadvantage compared to the counterfeiter. It would therefore mean that output VAT should have been charged on the trademarked goods, the other consequence is that input VAT should be allowed to be deducted to the extent it was incurred in making taxable supplies (art. 168 PVD). That does not mean that the supplier cannot be prosecuted for criminal charges separately although this is to be distinguished from VAT considerations. Concerning your company, BB should be able to deduct VAT incurred in acquiring such goods from the supplier provided that it can establish that it did not know or had no means of knowing that the supplier was fraudulent, which is grounded in the Kittel ruling by the CJEU. You would therefore have to demonstrate that you had performed appropriate checks on the supplier and were not aware that the goods were counterfeit. Assuming that you received these goods as part of an Intra-community acquisition, they would have been zero-rated and invoiced to you under art. 138 with a reverse charge accounted for by BB. As a customer, you would not necessarily have performed the same level of checks and it would have been difficult to assess if your supplier acquitted themselves of their VAT compliance obligations, which means it should be possible to demonstrate your good faith. However, that may be complicated by the fact that there seems to have been several prosecutions involving this supplier, it will be necessary to show that your due diligence process did not identify red flags.

Mail orders of phones and accessories

Under art. 135 PVD, the granting and negociation of credit is usually exempt from VAT. The credit component of a sale of goods would usually be subsumed by and be incidental to the main sale, being the goods under the principles developed in the Card Protection Plan ruling. It has no real identity of its own. If it granted goods on credit for EUR 800 to a client, it is only seen as a sale of goods (or distance sales depending on the destination), which means the whole amount would be charged the VAT rate that applies to the goods being supplied. The interest surcharge of 5% in case of late settlement is not compensation for a supply of goods and is not linked to the main sale, as such it is not a taxable transaction and sits outside the scope of VAT. If it was to be viewed as an early payment discount, it would usually need to result in a credit note to reflect the amended consideration, thus removing the VAT component of the discount (but it would be after the initial supply).

PART B

Question 3

Abuse of law

The groundbreaking CJEU ruling that pertains to this principle of

EU law is the Halifax case where a company had taking contrived steps to set up companies to claim VAT input deductions where known would normally have existed. Abuse of law is the 1) obtaining of a tax (VAT) advantage being the main or sole purpose of steps taken, and 2) it goes against the intention of the law (PVD). In practice, it is the situation whereby a person who should not normally have recovered VAT or should have paid more did so by deliberately creating a structure or chain of transactions that resulted in mitigating or cancelling its VAT liabilities (i.e., a VAT avoidance scheme). This principle has been used to counter abnormal and contrived steps and to allow Member States to take actions that are necessary to collecting VAT and preventing the avoidance of VAT - actions that must remain proportional and confined to these goals. Where an abuse of law is deemed to exist, the result is that the tax authorities can proceed with adjustments to bring the VAT liability back where it should have been had the abnormal steps not been taken. It will however not result in penalties as that would require both the intent and the letter of the law to have been broken.

Direct effect

Direct effect is the principle according to which EU Regulations and Directives should take precedence over national law and "directly" apply. A Regulation automatically has direct effect. However, a Directive does not as it first needs to be implemented into national within the prescribed timelines. Should the Member State fail to implement the Directive by the deadline it was set, there are cases where citizens could rely on the Directive, which will effectively supplant national law. For that to happen, the Directive has to be sufficient clear and precise, unconditional, and to give rights to citizens that they can assert against the state. The Directive can also be relied on if it gives a more favourable result than national law. It was illustrated in the Becker, Simmenthal SpA and VNO cases. Focusing on the Becker case, a German taxpayer was in a less favourable VAT position due to Germany not implementing provisions from the PVD within the prescribed deadlines; the CJEU found in favour of the taxpayer and the German tax authorities had to comply with the provisions of the PVD despite the fact they had not yet been implemented into German law.

Effectiveness

Effectiveness of rights is taken to mean that taxpayers should be able to assert their rights and that tax authorities should not make it excessively difficult for them to exercise such rights. This means there is a link with fiscal neutrality as it touches on the principle of deductibility of VAT on input costs incurred in making taxable claims (the Kittel case is a good example as it enshrines this principle by considering an incurably void contract not to prevent the transactions to have produced VAT effects including deduction rights as long as there was a taxable transaction). Rulings that fall within this principle are usually centered around the implementation of time limits for claims or sudden changes to legislation (such as options to tax being revoked) without given proper notice to taxpayers to take action. One such pronouncement was the Mark & Spencer ruling in which the United Kingdom decided to restrict without little notice time limits for VAT claims, which would have resulted in a rush to comply with the new time limits and afforded little time to take relevant steps. As a result, the time limits were found to be too restrictive.

Equivalence

Under the freedom of movement in the Treaty on the Functioning of the EU (TFEU), there is an overriding requirement for Member States not to discriminate against citizens or entities from other Member States and to grant them the same rights as afforded to their nationals. This is key to the functioning of the Single Market and to overcoming barriers to the free movement of people, capital, goods, etc. One such case that confirmed this principle was the Lease Plan Luxembourg ruling by the CJEU, which held that different interest rates being applied to operators from Luxembourg and Belgium created distortions and was not in keeping with the principal of equivalence.

Legitimate expectations

EU citizens should generally be able to rely on a (fairly) stable, predictable legal framework that allows them to make rational economic decisions without fear of major disruption without proper notice to allow them to get their affairs in order. Some of the case law that relates to the effectiveness principle could be seen to apply here as well since reasonable time limits (such as in the Mark & Spencer ruling) could also be seen as a component of legitimate expectations. The ability to rely on sound judgment and to be judged only once for one set of circumstances (*non bis idem*) would also be part of legitimate expectations.

PART C

Question 5

A fixed establishment would usually imply that there is a centre of management and decision-making within the subsidiary, that would usually mean local directors exercising meaningful decisions related to core activities. This would further be characterized by a certain degree of permanence, which could be in the form of premises (similar to the fixed place of business concept in direct taxation). It is not sufficient for assets to be located somewhere to constitute a fixed establishment (refers the Berkholz case in which gaming machines located aboard a ferry were not deemed to be a fixed establishment)or for a supply to happen (refers the Faaborg case). Nor would immovable property be enough on its own (Titanium case). The Berkholz case established the principle that, for a fixed establishment to exist, there would have to be sufficient "human and technical resources" for it to function. Likewise, in the Welmory case, the CJEU ruled that a Cypriot company was incapable of receiving a supply due to insufficient resources and that it effectively relied on the IT infrastructure of a Polish company which was deemed to be the real recipient of the services. It would tend to mean that if an overseas company sets up a subsidiary which is endowed with premises, employees, an IT infrastructure or similar assets, and is sufficiently permanent to receive services/goods and or provide these, it could be reasonably expected to be a fixed establishment, although it would remain open to question whether this fixed establishment actually intervened in a given transaction. There is a general "force of attraction" principle but it is rebuttable. A fixed establishment that would only support some administrative and/or clerical processes would be unlikely to be considered intervening, and the main establishment would usually be considered to be the recipient/provider of goods/services, for example.

In practice, fixed establishment rules are meant to provide a safeguard against abnormal outcomes or VAT avoidance schemes that would seek to channel VAT through jurisdictions were rates are lower. Where a subsidiary constitutes a fixed establishment and uses its own VAT number, it would usually be treated as intervening, although this can later be disproved under certain conditions. In case it cannot be established with sufficient certainty that the fixed establishment received a supply, there are fallback rules that would redirect VAT consequences to the main establishment of the company or, failing one, to the habitual residence of the person.

Question 6

Under art. 28 PVD, an intermediary - i.e., a party (B) that would for instance handle transportation between a seller (A) and a buyer (C) - could be considered an undisclosed agent if it acted on its own behalf but on account of another party (A) in a given transaction. If it were not acting on account of A, B would be considered a disclosed agent. The treatment for a disclosed agent would be as follows: B would issue an invoice for its commission (60) to A, using its VAT number in A's place of establishment (as that would be a service that is zero-rated and subject to reverse charge in A's Member State), it would then get an invoice from A for the goods it is transporting (100), and B will subsequently invoice C for the goods (100). Whilst under the undisclosed agent's option, B would directly invoice the net amount to A (being the goods minus its commission, i.e., 60) and B would then invoice C. C would provide its VAT number (now necessary if it is an Intra-community acquisition under quick fixes) to allow the supply of goods to be zero-rated and subject to reverse charge. In effect, the undisclosed agent treatment allows for some measure of simplification by removing one invoice from the the default process.