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THE VAT PACKAGE Assessing Readiness For 2010

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CHRIS WALSH AND ANDREW HALLSWORTH

ECOFIN, the European Commission's Economic and Financial Affair Council recently adopted[1] new value-added tax (VAT) legislation that will change the place-of-supply rules for services[2] and create a new electronic procedure for claiming cross-border VAT refunds.[3] The new rules are part of the "VAT package," which is primarily intended to change the rules to ensure that VAT on services accrues to the country where consumption occurs and to deter businesses from moving their operations to countries with lower VAT rates.

The new rules mean minor changes for some firms doing business in the EU, but they will require major changes for many others. The rules affect the cross-border sales of business-to-business (B2B) services most significantly, but all businesses should assess the impact of the changes on their business. The key changes involve:

- Change in the place of supply of B2B services, which will be tied to where the customer consumes the services rather than where the supplier is located. This might seem like a simple change, but it has the potential to cause huge problems for the unwary.
- Mini one-stop shop, which is being implemented for broadcast and telecom services by 2015, with an eye to eventually rolling it out for a wider range of industries. This will ultimately make it possible for a company to register once for VAT in a country of its own choice and have that registration apply across the entire EU—essentially an extension of the existing rules surrounding services supplied by electronic means.
- Expansion of the EC Sales List, which will apply to services as well as to goods supplied and require a greater level of detail in the report. This is a major new reporting burden for some taxpayers.
- Electronic VAT refunds, eliminating the paper-based method of applying for 8th Directive[4] refunds of VAT, improving the timeliness and efficiency of requesting and receiving refunds. Prima facie, this promises to be a major headache for the tax authorities but a boon for taxpayers.

Most troubling is that, while most of the changes are due to take effect on January 1, 2010, many of the details on exactly how the changes are to be implemented have yet to be outlined. This makes planning for the changes difficult, though there are steps that companies can take now to ensure their readiness, such as conducting risk assessment or investing in new technology (see Exhibit 1 on risk assessment).

Change 1: Place of Supply

There have been many difficult and unanswered questions surrounding place of supply for services, and it has taken a long time for the EU countries to come to agreement on these issues. From a business perspective, there has been a growing sense that the place-of-supply rules are too complicated. Taxpayers cannot be certain whether they are following the right rules in terms of VAT. Usually, VAT is due either in the country where the supply originates or in the destination country, but there are so many rules around place of supply of services that it has become very difficult to determine where VAT should be accounted for. The new rules aim to simplify this determination.

On the economic level, the rise of Internet-based and other electronic communications services has given companies the ability to provide services at a distance, from virtually any location. The EU has seen a significant and accelerating trend in firms locating their operations centers in countries with lower VAT rates, leading to what the EC called "distortions of competition"[5] between many EU member states, to say nothing of the shift in tax revenues. Changing the place of supply to the point of consumption reduces the incentives for businesses to relocate their operations centers, at least as a means of reducing their VAT burden.

The law. Under the new rules, beginning January 2010, B2B suppliers of services will be taxed where the customer is situated or where the supply is consumed rather than where the supplier is located, which is the current default place of supply. For B2C suppliers of services, the place of taxation will continue to be where the supplier is established and the existing distance sales rules will continue to be in effect.

Under certain circumstances, the general rules for suppliers both to businesses and to consumers will be overridden, and specific rules will apply to reflect the principle of taxation at the place of consumption. These exceptions concern services such as restaurant and catering, land and property supplies, the hiring of means of transport, cultural, sporting, scientific, and educational services, and telecommunications, broadcasting, and electronic services supplied to consumers.

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EXHIBIT 1
Risk Assessment

	Business	Government
Place of supply of services	• Implementation is January 2010, delayed to 2015 for telecom and broadcast industries. • Change has biggest impact on large services firms with cross-border transactions, but all companies should pay close attention. • Examine processes on determining "customer location" for each transaction. • Determine if response requires a cross-functional team or if it is an IT- or finance-specific project. • Reexamine decisions related to location or relocation of operations, as the tax rules may have changed the business case.	• Determine the amount of tax revenue that may be lost as services firms pay VAT based on the location of their customers.
EC Sales List	• Sales of services must now be reported. Many services firms must now file an EC Sales List for the first time. •The level of detail is likely to increase, requiring more information on the customer, invoice-level detail. • Filing will become monthly rather than quarterly, and businesses will have shorter timeframes to prepare the return.	•The changes need to be better defined, so that tax authorities and businesses can prepare. • Forms and filing procedures need to be updated. •Taxpayers need to be educated on the changes.
One-stop shop	• Already in place for electronically delivered services. • New changes affect only telecom and broadcast suppliers. • Deadline is 2015. • Expect one-stop shop to be applied *eventually* across all industries.	• Requires systems in place to handle significant revenue transfer between member states by 2015. • As much as 10% of VAT revenue may come in the form of transfers from other member states.
Electronic VAT refunds	• A major win for business if it happens. • Consider using technology to ensure that the refund request is properly submitted, because it is likely to be bounced back for the slightest error.	• Requires online systems in place to receive, process, and pay claims for VAT refunds. • Many states are so ineffective at handling the current manual system that refunds can take up to six years to process. Electronic refunds will make these inefficiencies more visible and less forgivable.

With regard to telecom, broadcasting, and electronic services, the introduction of the new rules on the place of B2C supplies will be delayed until January 2015. These services will be taxed in the country where the consumer is established. The sector may rightly regard this delay as a window of opportunity to enjoy establishments such as Luxembourg with low VAT rates for almost another seven years. Indeed, the delay to 2015 is testament to the power of the Luxembourg government's negotiating power at the Commission. (See Exhibit 2 for the wide range of standard VAT rates.)

The VAT package contains few other place of supply changes for B2C businesses. The short-term hire of transport and some catering services will be affected.

Practical implications. The place-of-supply changes are designed ostensibly as a simplification measure. However, for a business that delivers and receives services cross-border in the EU, the changes to the place-of-supply rules will require a wholesale review of its income and purchase streams to understand the extent to which the new rules affect them.

It will now become far more problematic for partial exempt businesses such as banks to gain VAT advantages by locating outsourced "management services" to locations outside the EU. Such services will now be reverse-chargeable when the banks receive them.

The question of "where a business is established" has never been a simple one. It has been the subject of countless court and tribunal rulings, and even more so now that it will be important to determine in which jurisdiction, for

Third-Party VAT Technology

The VAT package involves sweeping changes to the way that tax is calculated and reported. Many companies are wisely using this as an opportunity to reexamine the business case for investments in technologies such as VAT engines, which bolt onto existing financial systems and handle all tax calculations. There are several reasons why using third-party technology is an attractive option for many companies:

Expertise. While in-house staff once had to understand the tax rules only for locations where the company had an operations center, the new place-of-supply rules will require them to understand the rules for any EU country where the company has a customer. Third-party technology embeds this expertise into the software system, eliminating the need for companies to develop this expertise in-house.

Up-to-date. Tax rules change constantly, and many of the details in the VAT package will continue to change up to 2010 and beyond. Using third-party technology eliminates the need for a company to track, understand, and implement every change to the rules. It is the technology vendor's responsibility to keep up to date.

Flexibility. VAT engines are more flexible than off-the-shelf ERP systems or even most custom in-house solutions. They are designed to accommodate rule changes with a fraction of the effort needed to update the native tax capabilities of an ERP system.

example, a reverse-charge amount will be due, with the threat of penalties for incorrectness.

In particular, those who have VAT logic manually embedded within their existing ERP (enterprise resource planning) systems will need to make sure that the systems are ready to cope with the changes. January 1, 2010, may seem a long way off now, but in terms of running a full IT project, it will be here very quickly.

Preparing for this change will likely encompass a complete review of a company's systems, processes, and policies that touch on IT, finance, legal, and even sales, marketing, and operations. Of course, a change in technology should be considered, given the level of granularity that will be needed in tracking customer locations and determining the proper tax. "VAT engines," which interface with a company's ERP or finance system, are designed to handle this level of complexity and ensure that the tax calculations are correct. (See sidebar on reasons why third-party technology may be an attractive option for many companies.)

Change 2: Mini One-Stop Shop

The changes also provide an opportunity to advance some of the European Commission's longer-term goals. The Commission has been pushing for the mini one-stop shop for a long time, and it is now inching toward achieving that goal, industry by industry. The mini one-stop shop is currently in place for electronically delivered services and, by 2015, it will be in place for the telecom and broadcast industries. A successful implementation in those industries will presumably pave the way for a more generalized adoption. This will be a major step in simplifying taxation for businesses, as they would have to register only once in their choice of EU country and then would be able to account for VAT in all 27 EU countries.

The law. For the telecom and broadcast industries, the new place-of-supply rules have been delayed until 2015. Telecom and broadcast suppliers will also be permitted to discharge their VAT obligations using a one-stop shop plan that will enable them to fulfill their VAT obligations in a single country, including for services provided in other member states where they are not established.

In the one-stop plan, the VAT revenue from these services will be transferred from the country where the supplier is located to that where the customer is situated. The VAT rates of the customer's country will apply. To ensure a smooth transition, the member state of establishment will retain a proportion of the VAT collected until December 2018 (30% from January 2015 to December 2016; 15% from January 2017 to December 2018; and 0% from January 2019).

Practical implication. There are currently 27 EU countries, and companies that make cross-border supplies of services to EU consumers may be required to register in every country where they do business. The penalties for failing to register can be severe, which is one of the issues that make the change to the place-of-supply rules such a potential headache.

1 http://ec.europa.eu/taxation_customs/ taxation/vat/key_documents/legislation_recently_adopted/index_en.htm.

2 "Council Directive 2008/8/EC of 12 February 2008 amending Directive 2006/112/EC as regards the place of supply of services," Official J. of the European Union, February 20, 2008, L 44/11

3 "Council Directive 2008/9/EC of 12 February 2008 laying down detailed rules for the refund of value added tax, provided for in Directive 2006/112/EC, to taxable persons not established in the member state of refund but

The idea behind the one-stop shop is that such a business should not have to register in every country to be able to carry out business there. A business registers in one country, and then that registration is good for doing all B2C business throughout the EU. The difficulty is that businesses still have to charge VAT according to the location of their customers, so a company that has elected to register for VAT in the U.K. but has customers in France and Germany will have to report the French and German VAT that they have charged and pay that money over to the U.K. tax authorities. The U.K. tax authorities would then have to redistribute that money to the French and German tax authorities so that the VAT revenue actually ends up where it is supposed to be.

This is potentially a big simplification for a telecom or broadcasting business, which now needs only one VAT registration and one tax authority to which it answers and pays money. On the other hand, the change will represent a significant issue for these companies, as they have not previously been required to charge VAT country by country, so they may well encounter both finance and systems issues in their attempts to comply. The redistribution of the tax revenue is then left to the tax authorities themselves, which promises to be a big problem for them as well. It is the tax authorities who will have the major burden of preparing for this change, which is why it is being taken slowly, industry by industry. It was first implemented for electronically delivered services, such as downloading songs from iTunes, and now it will be implemented in 2015 for the telecom and broadcast industries.

established in another member state," Official J. of the European Union, February 20, 2008, L 44/23

4 Directive 79/1072/EEC, December 6, 1979 ("8th Directive") (for EU residents).

5 Council of the European Union, press release PRES/07/281, "Council Approves New Rules for VAT on Services, Requiring Taxation in the Country of the Consumer With a One-Stop System for Tax Payments," Brussels, December 4, 2007.

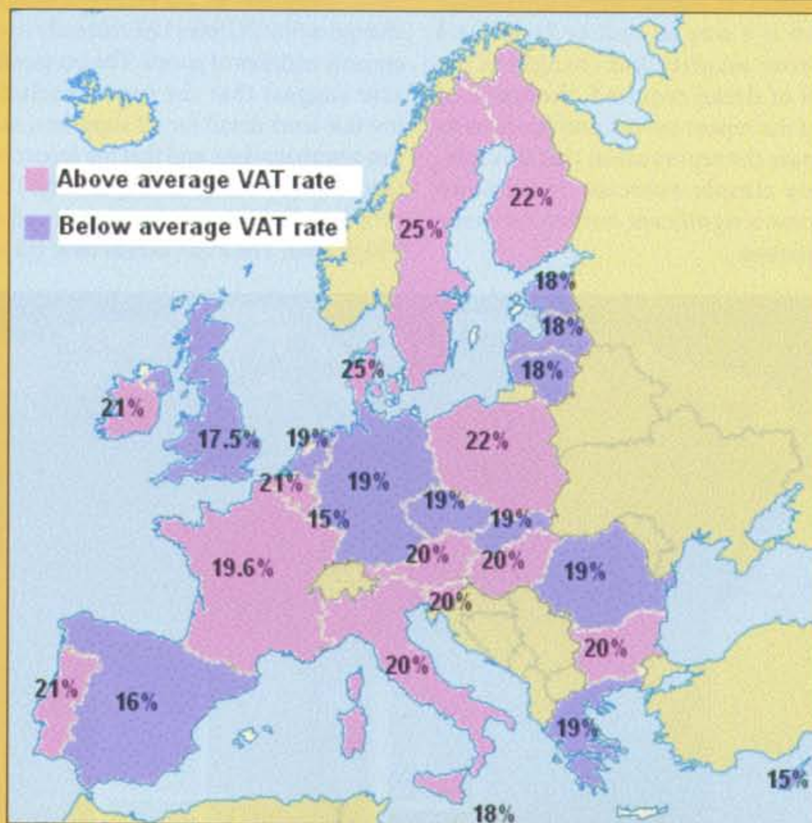
6 Directive 86/560/EEC, November 17, 1986 ("13th Directive") (for non-EU residents)

Change 3: EC Sales List

Another change is the expansion of the EC Sales List. Supporters of this change deem it a way to reduce fraud and improve security, but changes in the level of detail required, the scope of what the report covers, and the time to prepare the report mean that this relatively simple exercise could soon become a significant burden for many businesses.

The law. The VAT package includes proposals to extend the EC Sales List to cover suppliers of services—a major change, as the EC Sales List currently covers only supplies of goods. The proposals also suggest that the report include invoice-level detail for all suppliers, not just summary data, and that the report be filed monthly rather than quarterly. The proposals have already been approved at a high level. The exact details have yet to

EXHIBIT 2
Wide Range of Standard VAT Rates



The EU has seen a significant and accelerating trend in companies locating their operations in countries with lower VAT rates. Luxembourg, with its 15% VAT rate, has been a particular beneficiary of this trend. The VAT package is the latest move in the EU's drive to make VAT a consumption-based system, and though the present changes do not greatly encompass B2C (until 2015 at least), future moves in this direction can be expected.

be worked out, but the rules are still slated to take effect in January 2010.

Practical implications. The EC Sales List right now is a relatively straightforward, quarterly report that most companies can run off their computer systems pretty easily. It involves only three columns: customer VAT registration number, total value of supplies of goods to that customer in the quarter, and a check-box if any of those supplies involves a "triangular transaction." All of that is about to change. The new rules will be a major adjustment for companies that supply services, as in the past they have never had to complete or submit EC Sales Lists.

Other changes contemplated include making the reports a lot more detailed. For example, rather than just giving a grand total for how much has been sold to a particular customer in the quarter, the report may require listing it out by invoice. Suddenly, a one-page report is turning into many pages. Or the report may require more detail on the customer than just the VAT number. As noted above, there is talk of having the EC Sales Lists submitted monthly rather than quarterly, and with much shorter submission periods. At the moment, companies have six weeks at the end of the quarter to submit the report, but the timeframe could be shortened to as little as ten or 21 days after each month.

It is likely that businesses will need to know whether a customer based in another EU member state will treat the receipt of a service as VAT-exempt or self-accrue a VAT amount, since only cross-border supplies that generate VAT will be required on the Sales List. This in itself could be a monstrous task for suppliers, especially those in the finance sector.

In all, if implemented as proposed, this will be a huge burden on businesses, particularly in the services sector. It will clearly involve major system configuration issues, but exactly what the details will be remains to be seen. One thing for certain is that there will be an expansion of the EC Sales List to include supplies of services, and companies should watch carefully and seek tax advice to determine how it affects them and what they need to do to be ready. Companies should also consider implementing new software technologies, such as a VAT engine, that would shift the burden of implementing these new rules, whatever their final form, to the vendor of the software.

Change 4: Electronic VAT Refunds

Finally, there is the switch to an electronic system for requesting VAT refunds. Companies will be able to make claims for a refund of VAT that they have incurred in other member states under the existing 8th Directive provisions. Unfortunately, over the years it has become increasingly difficult to actually get VAT refunds from most EU tax authorities. It now takes approximately one year, and the worst offending country can take up to five or six years to pay a refund, if ever. Clearly the existing refund system has disintegrated and this has cost European businesses millions if not billions of Euros over the years. The clamor for change was so great that something had to be done to revamp the system.

The law. By January 2010, governments will be required to accept VAT refund requests electronically and to pay any electronic refund claims within four months of submission (assuming no queries from the tax authorities regarding the claims). There will also be strict timeframes that companies will have to follow in submitting their claims. It is slated that compound interest will

accrue for claims that tax authorities do not repay within the time limits.

This electronic system for VAT refunds applies only to companies covered by the 8th Directive, so it will be available only to companies established within the EU. Companies from outside the EU (covered under the 13th Directive[6]) will still have to submit their refund requests manually.

Practical implications. On its face, this is a major boon for businesses, but a potential nightmare for governments, many of which will have to scramble to get their refund systems in order in time for the deadline. The U.K. is currently the only country to keep to the deadline of providing a refund within six months. Most countries are taking about a year to issue refunds and a few take five or six years. A lot of money is at stake with this change and it is unclear whether all of the EU member states have the political will to make it happen. It is likely that some will lobby hard to delay the implementation of this rule or, as now, continue to take measures to unfairly delay repayments.

Enforcement is the key. The current manual process requires payment within six months, yet as noted above, only one of the EU countries manages to regularly meet this deadline. Attempts to enforce the deadline under the manual system have been almost completely ineffectual. It remains unclear what changes are being put in place that will ensure that the deadlines for the electronic refund system will be enforced, and whether the prospect of compound interest alone will provide a big enough stick for some member states.

For taxpayers looking for a refund, this is an area where an investment in technology can improve their chances. The four-month deadline has a loophole that allows governments to bounce back a refund request for missing or improperly filed documentation, a cash-management strategy that is sure to be used by more than a few EU countries. Technology that ensures that all of the necessary information and documentation is submitted in precisely the right format will make it less likely that a refund request will be bounced.

Action Items

With the deadline for most of these changes set for January 1, 2010, there are concrete steps that companies can take now to be ready for the changes:

- Improve awareness.
- Consider technology.
- Assess risk.
- Seek advice.

Awareness. As the EU has yet to work out many of the details to these changes, one of the most important actions that companies can take is to keep abreast of the changes by reading articles and announcements wherever possible. Now is also the time to start assembling a cross-functional team that can look at how the changes may affect the company's systems, processes, and policies. At a minimum, the IT department should be put on warning so that they are prepared to configure systems to handle the changes.

Consider technology. Many companies have put VAT engines in place as part of their overall ERP system. These technology tools use data from the main ERP system to determine the appropriate VAT and then pass it back to the ERP system. These engines are capable of providing a far higher level of tax automation and granular reporting than ERPs are typically able to manage. There is no doubt that the application of VAT technology will make these VAT package changes considerably less troublesome, as the details of handling the new rules can be left to the vendor.

Those without VAT engines in place might reexamine the business case for implementing one, as the return-on-investment profile may well be affected by these changes. Many companies will find that rather than having only a few locations to account for in VAT calculations, the system may in the future need to determine tax for numerous EU member states. This could require someone on staff to be or become the in-house expert in the rules and regulations of each EU member state so that the system can be kept up to date with the requirements. With a professional VAT technology solution, it becomes the vendor's responsibility to keep the software current.

Assess risk. These changes will not affect all companies equally. Some businesses will hardly even notice the change. The companies at greatest risk are the large services companies—the changes to place of supply and the EC Sales List will affect them the most.

Also, the more cross-border business, the more impact that these changes will have on a company. Firms that supply services in a wide range of EU countries are especially at risk.

Seek advice. The changes are complex enough that it may be worth seeking outside advice to help keep on top of details of how the new legislation is being developed and implemented and to assess the full impact that the changes will have on the business. If the changes to the point-of-supply rules require VAT registration in additional EU countries, outside VAT specialists can help navigate through any unfamiliar territory.

Conclusion

The VAT package rules taking effect in January 2010 mean minor changes for some firms doing business in the EU, but they will require major changes for many others. The rules affect the cross-border sales of B2B services most significantly, but also some B2C suppliers. It is highly recommended that all businesses assess the impact of the changes on their business. Key questions include:

- Do the business's existing systems need to be reconfigured?
- Are there experts that can help in the transition?
- Is this a time to consider VAT engines and other technologies?

The time is short, but action now will help businesses be ready for the change. ●