

Kluwer International Tax Blog

Cross Border Revolution

Karl-Heinz Haydl (General Electric Germany) · Thursday, June 25th, 2015

Importance of legal certainty in cross-border scenarios

In the context of the EU VAT system, the principle of legal certainty requires that Community legislation must be certain and its application foreseeable by those subject to it.

In practice, however, national VAT laws often deviate from the EU VAT Directive due to differences in local interpretation or implementation of the rules. Where there are differing and contradictory views across Member States, this leads to a lack of legal certainty in respect of EU cross-border transactions which in turn can lead to instances of double taxation and unintended non-taxation.

These inconsistencies in the common EU VAT system create a great deal of risk management work for VAT practitioners, monitoring ongoing activities and reviewing new activities to give reasonable certainty regarding the financial impact of VAT on the business in order to determine and manage expectations in terms of the economics of a deal and the wider business plan.

Let's take a look at some examples of risks that arise in an EU cross-border environment:

- Double taxation and unintended non-taxation – business wants to avoid double taxation, which can easily ruin the economics of a deal, but neither is unintended non-taxation every VAT practitioner's nirvana since it creates legal uncertainty for business – will the circumstances of non-taxation be challenged or change and if so when and with what impact? Unless exempt, a fair starting point is to say that a transaction should be taxed for VAT purposes somewhere in the EU (but only in one place).
- Incurring foreign VAT (ie, in a jurisdiction where the business is not VAT-registered) can create a negative cashflow impact or an absolute cost if recovery is difficult or uncertain (as it is in a number of Member States).
- Fulfilling compliance obligations in a foreign country is onerous – a myriad of VAT obligations and questions abound on registering in another jurisdiction. And there is an additional layer of legal uncertainty due to the lack of widely available information on VAT compliance for each Member State. NB: the much discussed concept of an EU VAT web portal would certainly help here.
- Penalties vary widely between Member States and can be severe, even when a taxpayer acts in good faith and even where there is no tax loss.

Dealing with the VAT regime in a different EU country can lead to a great deal of uncertainty and

in some circumstances can have a very negative financial impact for a product that is tried and tested elsewhere. These are unwelcome anomalies in a common EU VAT system since a proper functioning of the single market requires a VAT system that provides legal certainty and a level playing field for everyone. It's important to note that, albeit from the other side of the fence, tax authorities also need legal certainty as they want to receive the right amount of tax at the right time in the right country.

Is there any help at hand? Well, from our perspective, the test case for VAT ruling requests relating to cross-border situations ('CBR') is a really encouraging initiative to try to resolve some of these difficulties.

CBR – what is it?

The CBR emanated from discussions at the EU VAT Forum where tax authorities and business meet to discuss VAT administration issues with a view to improving the practical functioning of the EU VAT system. To date, 15 EU Member States have agreed to participate in the project which initially ran from 1 June to 31 December 2013, but has now (thankfully) been extended to 30 September 2018. In brief, taxable persons intending to enter into a cross-border transaction involving any of the participating Member States may ask for a ruling on the VAT treatment of that transaction (subject to certain conditions) if the position is unclear. The relevant tax authorities then consult each other with a view to delivering a common view of how the VAT rules should apply in that specific case. Further details can be found [here](#), including the current list of anonymised cross-border rulings already given.

Slow uptake from business

There has been some concern that, so far, business has been slow to take up this new opportunity. That shouldn't be taken to mean that the EU VAT system is legally certain and situations of double taxation don't exist within the EU. On the contrary, it's clear from the examples already submitted that double taxation is a familiar reality within the EU, although business would argue that this was already well known to them.

However, there are some simple enough reasons that might explain an element of hesitancy on business' part:

- Overall the initiative was launched in a rather low key way to avoid a deluge of requests.
- There are 13 member States not yet participating – their support is needed.
- There was an issue with the scope of cases eligible for submission, limiting requests only to intended transactions and excluding those with legal effects in the past. This approach seems now to have been relaxed.
- Timeframe for response – the EU Commission's interim report ([link](#)) noted that 6 months was considered to be a very long time to wait for a ruling. One clear commercial trend is the need to act with ever increasing speed. Speed to market is critical and having legal certainty in tax matters is a vital part of achieving this.

Against this, there are notable strengths of the test case which in our view far outweigh the deficiencies:

- It's a new platform that establishes a process and identifies competent officials that are accessible to the business community. That is a massive step forward and expands the boundaries of

communication and collaboration between business and tax authority.

- A CBR can resolve legal uncertainty in cross-border EU trade and prevent double taxation. As such, it represents a viable alternative to impractical, costly, slow and uncertain court proceedings.
- Obtaining legal certainty can lead to significant reductions in compliance costs for business and administration costs for tax authorities.
- Clearer visibility for the EU Commission and Member States over the functioning of the VAT system – in particular, where improvement is needed.
- Publishing anonymised rulings can assist business and tax authorities in their understanding of a particular issue. That said, caution is needed where agreement between Member States has not been reached since it would be unhelpful and indeed create greater legal uncertainty for such rulings to be published.

Developing and improving the CBR

In its recent opinion ([link](#)), the VAT Expert Group (the Commission led group of expert stakeholders that assist in the development and implementation of VAT policies) noted that “Developing this initiative further and making it a success requires more time and engagement from various stakeholders – Commission, Member States and business”.

The VAT Expert Group opinion also lists a number of areas of potential improvement of which the most interesting and pressing is what happens next when Member States are unable to agree a common position with the result that double taxation arises (NB: the CBR does not oblige Member States to come to a shared conclusion). Under the CBR test case, Member States must deliver rulings according to the practice set out in their national legislation. This enabled the CBR to be set up with relative speed and ease. However, a fully harmonised EU ruling system with common rules and regulations across all 28 Member States would be preferable in the long term, also to include a clear procedure for resolving disputes. The VAT Expert Group opinion hints at certain possibilities that could be implemented to ensure that a business is not left in limbo indefinitely.

Here are some further thoughts on potential solutions:

- Referral and discussion in other EU bodies might help to resolve disputes – eg, the VAT Committee, EU Commission, VAT Expert Group, EU VAT Forum.
- Taking this one step further, some consideration could be given to whether a new advisory body could help and with the possibility for business stakeholder engagement in the process.
- Improving the law – eg, via an Implementing Regulation or the Commission could consider drafting proposals to amend the VAT Directive itself if more significant revision is required.
- Less practical and less certain, but infraction proceedings could help with potential infringements of EU VAT law referred to the CJEU. Some might also wonder whether the CJEU should have a specialist VAT division, given the complex nature of the tax.
- Looking at best practices across the EU, provided it can be substantiated that a supply has been taxed in one location, a pragmatic solution always available is for a Member State to give up its taxing rights. Wishful thinking perhaps, but we’ve seen it done before.

In the long term, the success of the scheme will ultimately depend on its capacity to deliver results and for that there needs to be a clear commitment to a conclusive process that respects the rights of the taxpayer and the basic principle that a transaction can only be taxed once. If you have further ideas here we would love to hear them, as would the Commission.

What is clear is that we have a great starting point for something which up until very recently nobody could have imagined possible – a formal mechanism allowing business to ask Member States to collaborate and cooperate with each other in considering complex cross-border VAT issues. From a business perspective, let's not take that for granted – whilst there is room for improvement, this is a revolutionary step that is now primed for further evolution. From the business side, we need to demonstrate the CBR's worth by using it and by encouraging the 13 other Member States to join the party. Spread the word!

This post is co-authored by Karl-Heinz Haydl and Mark Hammond Giles, VAT practitioners at GE. It is written in a personal capacity and does not represent the views of the company.

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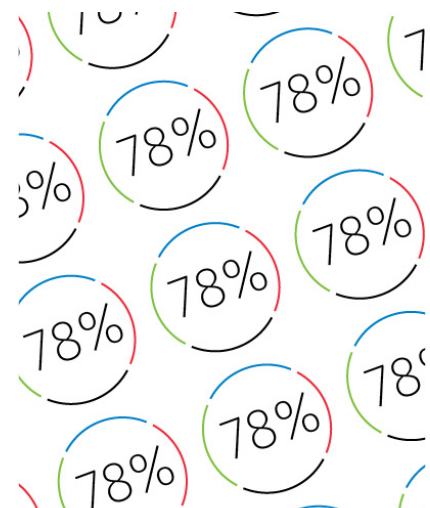
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