

The VAT package: overview and preparation – Part I

TAX

As previously informed, due to the directives adopted by the European Council in 2008, from 1 January 2010 the rules of VAT will change significantly all over the European Union. The proposal for the Hungarian implementation of the changes referred to as “VAT package” is currently under discussion at the Hungarian Parliament. In this newsletter, we summarize the main impacts of the proposal including the latest proposed modifications.

In the first part of our newsletter, we present the significant changes, together with practical comments and advice – *marked in italics*.

In the second part of our newsletter, we will provide a detailed overview of what our clients should do in preparation for the changes under the VAT package.

VAT package seminar at KPMG

There were nearly 200 participants at the seminars held by KPMG at the end of August, where the main issue was the Hungarian implementation of the VAT package. The seminar examined the planned changes from a practical point of view, including their advantages, disadvantages and impact on businesses. According to the feedback, the participants found the seminars very useful, and the event helped them start their preparations. In our current newsletter we touch upon the practical questions raised by the participants of our seminars, and some possible solutions.

Main changes under the VAT package as from 1 January 2010:

- restructuring the place of supply rules for services and the related reverse charge rules;
- EC listing for intra-community services;
- Changing the VAT refund procedure for non-resident companies established in the EU but not established in the given member state

New Place of Supply Rules

The most radical changes can be expected in the way the place of supply of services is to be determined,

i.e. in the rules defining the country in which cross-border supplies of services are subject to taxation. In the future, substantially different rules will apply for services supplied to taxable persons and to non-taxable persons (e.g. private persons).

Place of Supply of Business to Business (B2B) Services

According to the new rules, B2B supplies of services will be taxed **in general where the customer is established** (seat or permanent establishment). This is the opposite of the current main rule where the place of supply of services is where the service provider is established. The new main rule in general will cause lower cash flow burdens

regarding VAT, since it will be a rare exception when the service provider will charge the VAT of its own country to the customer.

Specific rules will exist in the future regarding the determination of the place of supply. In the case of B2B supplies the specific rules will only apply to a few types of services:

- Services connected with immovable property (including leasing and hotel services);

- Passenger transport;
- Cultural, artistic, sporting, scientific, educational, entertainment and similar services;
- Restaurant and catering services;
- Short-term hiring of a means of transport (in general for 30 days, 90 days for vessels).

The new main rule may cause an increasing VAT burden for Hungarian taxable persons with no right for VAT deduction in case of certain services rendered from other countries, since the Hungarian 25% VAT rate will be applied to services which were previously subject to a lower foreign VAT rate.

Based on the current and the future specific rules we summarize the main changes in the table below.

B2B supply	Until 2009	From 2010
Main rule	Where the supplier is established	Where the customer is established
Connected with immovable property	Where property is located	Where property is located
Passenger transport	Where transport takes place	Where transport takes place
Cultural, scientific and similar services	Where physically carried out	Where physically carried out
Restaurant and catering services	Where the supplier is established	Where physically carried out, or place of departure (during transport)
Short-term hire of means of transport	Where the supplier is established	Where put at disposal
Agency services	The place of the underlying supply, or per tax number of the customer	Main rule: where the customer is established
Transport of goods	Where transport takes place	
Intra-Community transport of goods	Place of departure, or per tax number of the customer	
Work on goods, valuation of goods	Where physically carried out, or per tax number of the customer	
Long-term hire of means of transport	Where the supplier is established	
Immaterial services (Article 46 of the Hungarian VAT Law)	Where the customer is established	

What is appropriate documentation of certain transactions could be questionable in practice. For example, in case of short-term hiring of a means of transport, the documentation of the place where the vehicle is put at the disposal of the customer could take a number of forms (e.g. on the basis of the order-form, contract, on-site minutes). Even the definition of short-term (30, or 90 days) is uncertain since the concept of continuous usage is also ambiguous – in this regard EU guidelines are expected.

As a new concept, the law would consider catering on board ships and planes a taxable service; whereas the sale of goods for consumption on board will remain VAT exempt. The split treatment is likely to provide some difficulties in practice.

Taxable or Non-Taxable Person?

The new legislation will more accurately determine the rules when a customer needs to be considered a taxable person. Those who have an intra-Community VAT number will be considered taxable persons in relation to all services provided to them, i.e. it is not relevant whether or not they act as taxable persons. Only regarding services for their own personal use or for that of their staff should they be considered as non-taxable.

In the European Community, the Community VAT number unambiguously identifies taxable persons. For practical purposes, it can be more difficult to determine if a customer from a third country is a taxable person. It would be advisable to ask a statement in advance from third-country customers that they carry out economical activity in their home country and are not acting as private persons. This declaration may also appear in the general terms and conditions of contracts. Identifying private usage can also cause difficulties in practice. For services where private purpose is frequently possible, the customer may be asked to make a declaration on this.

Effective Use

According to the new regulations in many Member States, the test of effective use and enjoyment is becoming more relevant. In Hungary, these criteria are only to be considered for the hiring of a means of transport: if the place of performance is in Hungary, and the actual use is in a third-country, the transaction will be outside the scope of VAT; while the lease will be taxable in Hungary if the place of performance is a third-country, but the actual usage of the means of transport is in Hungary. Since other Member States can extend this special provision for a wider range of services, it will be advisable to investigate where tax liability arises in cases of complex transactions involving several countries.

Reverse Charge Rules

If the supplier is not established in the country where the supply is made, the new legislation maintains the reverse charge (i.e. settlement of VAT by the customer) as the general rule for intra-Community transactions. Reverse charge transactions will become even more prevalent. This means that the supplier can issue its invoice from abroad without charging VAT, and the customer accounts for local VAT. On the other hand, if the given Member State does not apply the reverse charge for certain service types (e.g. services connected with immovable property), the foreign service provider must register as a taxable person in that Member State.

In spite of the new rules, it remains uncertain when the reverse charge may be applied to intra-Community transactions if the service provider has a fixed establishment in the Member State of the customer. In this case, it may have to be examined whether or not the fixed establishment is relevant to the supply. This issue – together with other subjects – awaits clarification at the EU level, and the European Commission also plans to issue guidance.

A change in the Hungarian legislation will allow immediate VAT deduction for reverse charge VAT, even without an invoice. This will hopefully prevent VAT payment obligations without a right of deduction in the future. At the same time, it can be a problem that for reverse charge services falling under the main rule, the customer is obliged to declare VAT on the day of performance, even if it is not aware of the details of this supply. When configuring systems, it should be taken into account that for the rest of the reverse charge services (e.g. services connected with immovable property, or hiring of means of transport) the complex rule remains in effect. VAT will have to be declared at the earliest of: the month following the performance; the receipt of the invoice; or the date of payment.

Place of Supply of Business to Customer (B2C) Services

Regarding the services provided to non-taxable persons, the main rule will not change (being the seat or permanent establishment of the supplier). The specific rules will also need further attention. Practically all current specific rules (e.g. transport of goods, work on goods) remain valid, while the new place of supply rules (e.g. restaurant services) should also be considered.

In 2011, 2013 and in 2015 further significant changes will take effect for services supplied to non-taxable persons. These changes are not yet covered by the Hungarian proposal, but they can be found in the European directives.

It is important to take into consideration the transitional rules of the VAT package as well. For example, in case of an advance payment for a service taxable in 2009 (e.g. contract manufacturing), if the final performance will be outside the scope of VAT in 2010, the VAT liability regarding the advance payment will have to be cancelled retroactively.

What Does This Mean In Practice?

- Currently taxable services will be without VAT from 2010 – cash flow/tax advantage
- Reverse charge becomes more frequent, less foreign VAT refunds- cash flow advantage
- Administrative changes
- The place of supply for taxable and non-taxable persons will be different more often

Recapitulative Statement

According to the proposed amendments taxable persons will have to submit recapitulative statements in electronic form on:

- Intra-Community exempt supplies of goods
- Intra-Community acquisitions of goods
- Intra-Community supplies of services falling under the main rule
- Intra-Community receipts of services falling under the main rule

Similarly to the current requirements, the recapitulative statements will have to include, for each of the above-mentioned transaction types, the intra-Community VAT number of the business partners, and the total net amount of the transactions taking place during the period per customer/supplier.

The wording of the proposal is not fully clear, but it seems exempt services – such as financial services – will not be subject to the recapitulative statement. To decide whether or not a service is exempt, the rules of the country where the supply takes place should also be considered: based on the Hungarian rules for services received, and based on the rules of the country of the customer for services provided.

An important change is that the filing frequency of the recapitulative statements will be in line with the VAT return filing obligation of the taxpayer, i.e. those which submit their VAT return monthly, should also report the recapitulative statements monthly; while those submitting VAT returns quarterly should submit the recapitulative statement quarterly as well. If the exempt intra-Community supplies of the taxpayer should reach a certain

threshold, the reporting frequency will change to monthly, but tax return submission could remain quarterly.

Foreign VAT Refunds from 2010

The new procedure will change the VAT refunds to electronic filing. In future, the request will have to be submitted through a web portal to the tax authorities of the Member State where the company is established. This rule applies to all applications submitted after 1 Jan 2010, including those for 2009. Thus, Hungarian taxpayers will reclaim VAT from abroad through the web portal of the Hungarian tax authority.

The applicants will still have to monitor the rules of several Member States, since both the rules of the country where they are established (e.g. partial deduction rate in case of exempt and taxable mixed activities) and of the Member State of refund (e.g. prohibited deduction) will apply. There will be an emphasis that the applicant is only allowed to request a VAT refund from another Member State in line with its own pro rata deduction, and if the rate is subsequently changed, an adjustment will have to be carried out. At EU level transaction types will be listed under special codes, but Member States can also define their own sub-codes, where they require further breakdown.

KPMG in Hungary and in all EU countries will still be pleased to assist our clients in the preparation and submission of VAT refund claims. Although the application should be filed direct to the Hungarian tax authority, if the taxpayer is not aware of the special rules and regulations of the Member State of refund, there is a significantly higher risk of rejection or at least extended correction procedures may be required, sometimes in a less known language of the Member State of refund. In order to receive the refunds as quickly as possible with a lower risk of failure, it is recommended to turn to experienced professional advisors.

The tax authority of refund may request additional information direct from the applicant or even from its supplier.

The submission deadline for the application is extended to 30 September of the following year. New deadlines will apply both to the taxpayers and to the tax authorities in deciding about the claims – according to the main rule the decision has to be made normally in four months, but even where multiple requests for extra information are sent, in eight months at the latest. In case of late payment, the tax authority will have to pay interest.

Although the intention of the proposal was to reduce the administrative burden on taxpayers, the new system is expected to cause difficulties on the proceedings despite the fact that the communication will be mainly carried out through the national tax authority of the taxpayer. Specific rules will be issued on the implementation of the technical details (e-mailing system, form and content of the application and adjustment process), which will be published in secondary legislation. Accordingly, not only the main law will need the attention of applicants.

Other Changes

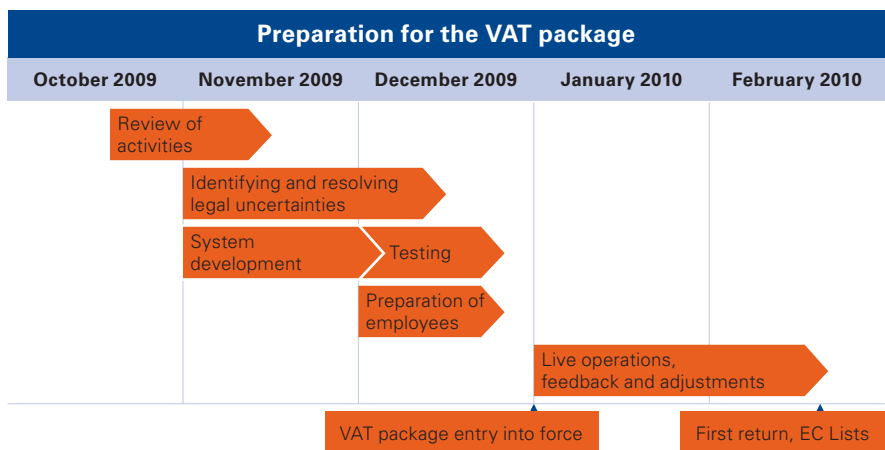
The proposal discussed by the Parliament includes changes other than the VAT package as well. Some of the most important proposals for taxpayers are the following:

- Assignment of Receivables: the restriction will be eliminated that the assignment can be subject to VAT if the purchaser of the debt does not provide services to the assignor.
- Periodic settlement: for services with periodic settlements received from abroad, if covering more than twelve months, the date of supply will be 31 December.

- Interruption of a lease: for close-ended financial leases, the tax base can be subsequently reduced if the lessor terminates the transaction due to the financial default of the lessor.
- Sale of commercial immovable property: similarly to leasing, the sale of real estate will also allow the option for taxation. The amendment of previous declarations can be submitted until the end of January 2010.
- Information on option for taxation: in case of sale of immovable property subject to the reverse charge, customers may ask the vendor or the tax authority for information on whether or not the vendor opted for taxation.
- Export-related services: services, including transportation related to goods dispatched to outside the Community are exempt, even if the goods are not sold at this time.
- Simplified VAT warehousing: with the appropriate license, it will be sufficient to submit certain documents to the operator of the warehouse instead of the customs authorities
- Definition of passenger: the special rules regarding tour operators will apply once again to a wider range of services – the recipient of the services can be any customer which acts ‘in its own name and on its own behalf’, not only the ‘actual traveler’.
- Customers of sport services: sport related services provided to non-natural persons may also be exempt.
- Exemptions for small taxpayers: small taxpayers with tax exemption are allowed to deduct VAT for services supplied to third countries.
- New information on the website of the tax authority: publication of information regarding the seat and the permanent establishment of taxpayers.
- Transfer Pricing documentation in foreign languages: the tax authority may request the records in Hungarian translation.
- Database of taxpayers with no tax debt: the database can be used more often as a replacement of ‘no debt’ tax certificates.

Preparation

The Hungarian parliament will likely pass the implementing law for the VAT package in the next weeks. Preparation for the changes – especially in case of companies often involved in cross-border supplies of services – should start as soon as possible, in order to ensure flawless operation of systems from January 1. A possible action plan for preparation could be as follows:



In the second part of our newsletter we will provide more information on the tasks at hand and practical advice to assist with preparation for the changes. If you are interested in the above, or if you have questions about the VAT changes, please feel free to contact Balázs Földes (+36 1 887 – 7232, balazs.foldes@kpmg.hu) or your usual advisor in the tax department of KPMG.

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