THE EVOLVING VAT LANDSCAPE

What U.S. businesses need to know

Nov. 7, 2016
Today’s presenters

Rob Dew
Senior Manager
• 20+ years in the Canadian sales tax consulting field
• Exposure to a wide range of business segments, including manufacturing, technology, healthcare, consumer and retail, financial services

Duncan Stocks
Principal
• Leads the national U.S. value added tax (VAT) practice and provides global VAT advice to multinational companies
• Advises on supply chain efficiency; existing structures as well as effective implementation of new structures
## Agenda

<table>
<thead>
<tr>
<th>Topics</th>
<th>Minutes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Welcome</td>
<td>3</td>
</tr>
<tr>
<td>Value-added tax (VAT) principles – place of supply</td>
<td>20</td>
</tr>
<tr>
<td>Transaction scenarios</td>
<td>20</td>
</tr>
<tr>
<td>Global changes</td>
<td>10</td>
</tr>
<tr>
<td>Closing thoughts</td>
<td>7</td>
</tr>
</tbody>
</table>
VAT PRINCIPLES

Place of supply
Value-added tax

- A tax applicable to the transaction
- Defined by the place of supply, which is not necessarily determined by the location of the counterparties to the transaction
- Evidence dependent (documentation)
- Strict time limits apply for compliance
Introductory comments

- Approximately 150 countries operate a VAT system
- Constantly changing requiring up to date response strategies
- All U.S. multinationals are exposed to VAT to some degree
- Known by different names in different jurisdictions, but is generally referred to as VAT
- Some countries operate a multi-level VAT system whereby there is both a federal VAT and a local (state/province VAT), e.g.:
  - India, integrated goods and services tax (GST), central/state GST
  - Brazil, Imposto sobre Operações Relativas à Circulação de Mercadorias e Serviços de Transporte Interestadual e Intermunicipal e de Comunicações (ICMS), Imposto sobre Produtos Industrializados (IPI), Imposto sobre Serviços (ISS), Contribuição para os Programas de Integração Social e de Formulação do Patrimônio do Servidor Público (PIS), Contribuição Social para o Financiamento da Seguridade Social (Cofins)
  - Canada, GST, harmonized sales tax (HST), provincial sales tax (PST)
- VAT has an enterprise wide effect as many functions influence VAT decisions and compliance requirements
Principal concepts

- A tax on each leg of a transaction made by a taxable person
- A credit for VAT expense is generally allowed if the expense was in relation to the taxable activity of the business
- Businesses effectively tax the incremental value of the onward supply
- The end consumer ultimately bears the full burden of the VAT charge
- VAT compliance typically follows the place of supply
- VAT rates may vary depending on the nature of what is being supplied and possibly the identity of the counterparties
VAT basic concepts

### Raw Materials
- **Supplier**: $100
- **Manufacturer**: $300

### Retailer
- **Sales**: $800
- **Cost of Sales**: $500
- **ITC**: $15
- **Net Tax**: $10
- **Net Tax** = $5 + $10 + $10 = $30

### Calculations
- **Tax**: $5
- **ITC**: $(15)
- **Net Tax** = $5 + $10 + $10 = $30
Transaction types

Most transactions will broadly fall into one of the groupings below:

- The sale of tangible property
- The sale of immovable property
- The lease of tangible property
- The lease of immovable property
- The sale or lease of intangible property
- The provision of services
In order to decide how to tax a transaction it must first be determined:

- What is being supplied?
- Where is it being supplied?
- When is it being supplied?
- Who is supplying it?
Tangible property – place of supply

- General definition:
  - The supply of goods (tangible property) shall mean the transfer of the right to dispose of tangible property as owner

- Place of supply is the location where the right transfers
Immovable property – place of supply

• General European Union (EU) definition:
  o The supply of immovable property shall take place where the immovable property is located
• This typically refers to land and buildings, but can also refer to structures attached to the land or are beneath the surface of the land
Lease of tangible property – place of supply

• General EU definition:
  o The lease of tangible property to a taxable person is supplied at the place where the taxable customer belongs
  o The lease of tangible property to a nontaxable person is supplied at the place where the supplier belongs

• Special rules apply to hiring means of transport
Lease of immovable property – place of supply

- General EU definition:
  - The lease of immovable property shall take place where the immovable property is located
- In a similar vein services specifically relating to immovable property will also be taxed at the same place, such as:
  - Architects (and other design services)
  - Surveyors
  - Construction/demolition
  - Security
  - Maintenance
  - Estate agents
eServices to nontaxable persons

- Depending on the jurisdiction, eServices (the provision of broadcasting, telecommunications and entertainment through the internet) are generally either:
  1. Taxed at the place where the customer belongs
  2. Taxed at the place where the supplier belongs
- Some additional rules might apply based on the place where the services are ‘used and enjoyed’
Establishment

• A VAT establishment (EU definition) is defined by an operation that has the human and technical resources to make and receive supplies.
• It does not imply that it is making supplies and does not mean that is required or entitled to be registered for VAT.
• VAT registration is required by organizations or establishments that make taxable supplies.
• An establishment for VAT purposes is not the same as permanent establishment for income tax purposes.
• The rules of ‘force of attraction’ may require an establishment to register for VAT.
Canadian registration requirements

- Issue: Whether or not a nonresident person is carrying on business in Canada for GST/HST purposes. As ‘carrying on business in Canada’ is not a defined term, then it is a question of fact.

- GST/HST policy statements have been issued to assist companies in making the decision as to whether they should be registered for GST/HST or not.

- Every nonresident person who carries on business in Canada, other than a small supplier, must register for GST/HST purposes if the nonresident person makes a taxable supply in Canada (subsection 240(1) of the Excise Tax Act).

- However, there are a number of factors that will be considered in determining whether a nonresident person is carrying on business in Canada.
Canadian registration requirements

- Factors:
  - Place of delivery
  - Place where agents / employees of nonresident are located
  - Place of payment
  - Place where purchases are made / assets are acquired
  - Place from which transactions are solicited
  - Location of assets / inventory of goods
  - Place where business contracts are made
  - Location of bank account
  - Place where nonresident’s name and business are listed in a directory
  - Location of branch / office
  - Place where service is performed
  - Place of manufacture or production
TRANSACTION SCENARIOS
eServices – Business to consumer (B2C)

Many jurisdictions now treat the place of supply as being where the individual belongs or where the service is used and enjoyed.

Service examples:
- Online gaming
- Video streaming
- Downloads (music, software, etc.)
- Email services
- Telecommunications

Consequence:
U.S. supplier has potential liability to register for VAT in the location where the customer belongs or the service is used and enjoyed.
Local inventory stocking

Most jurisdictions treat the place of supply as where the title in the goods transfers

Consequence:

VAT registration and accounting obligation arises in the country where title transfers

Goods imported or locally sourced will likely have additional VAT costs to manage which would ordinarily be recoverable
Supply and install contracts

Most jurisdictions treat the **place of supply** as where the title in the goods transfers.

Title to installed goods does not generally transfer until they are installed (i.e., at the location of installation).

Consequence:
- Local VAT registration
- Local VAT costs
The tangible product is always owned by the principal (U.S. supplier). The manufacturer provides a processing service.

Consequence:

VAT will likely be incurred on any product imported or locally sourced.

**VAT registration** likely required to recover VAT costs and manage onward supply.
Foreign held real estate (immovable property)

Most jurisdictions treat the **place of supply** as where the real estate is located.

In addition, many jurisdictions provide an optional election to charge VAT on commercial rent and disposals.

Consequence:

Local VAT registration; or irrecoverable local VAT if supply is treated as exempt from VAT.
Most jurisdictions treat the place of supply as where the real estate is located.

Consequence:

**VAT registration and accounting obligation** arises in the country where title transfers.

The act of subcontracting does not absolve the principal from its VAT obligations.
Agency structures

Confirm agency type – sales agent or agent as principal

Confirm customer status – Business or consumer

Consequence:

The principal will be responsible for managing any VAT obligation

NB – Intercompany agency structures and internet agents (e.g., Amazon)
Brexit

• No fixed timeline as Article 50 of the Lisbon Treaty not yet invoked
• Potential VAT impact:
  – Loss of single market benefits
    o Trade, people, cash
  – Increased trade barriers
    o Customs controls – import VAT at time of entry
  – VAT rules and regulations may be amended
  – European Court of Justice (ECJ) will likely cease to hear United Kingdom cases during the process
  – Accounting systems and processes will likely need reconfiguring
  – A two-way effect with other EU countries
• Speculation that revenue customs Her Majesty's Revenue and Customs may be pushing for a VAT union, much like the customs union which includes non-EU countries
India

• 13 years in the decision process, but now it is confirmed that India will implement a federal GST system with effect from 2017 (target date April 1)
• Two VAT laws proposed
  − The Central/State Goods and Services Tax Act, 2016 (CGST)
  − The Integrated Goods and Services Tax Act, 2016 (IGST)
• Ambitious implementation plan and timeline
  − Approval process at both the center and within the United States
  − Infrastructure investment (particularly IT)
  − Administration processes and procedures
• Various central and state level taxes will be subsumed within the new GST model
• GST Council will be formed to administer the tax
• Rates anticipated to be in the 15 percent–18 percent band (but not yet confirmed)
Gulf Cooperation Council (GCC)

- United Arab Emirates (UAE), Kuwait, Saudi Arabia, Qatar, Bahrain, Oman
- Introduction of VAT at 5 percent with effect from Jan. 1, 2018 in the UAE
  - First phase registration threshold AED 3.75 million turnover (circa $1 million)
- Other GCC countries at the same time or by Jan. 1, 2019
  - Staggered roll out could lead to intra-state distortions
- VAT Framework Agreement to be finalized by the GCC Financial and Economic Cooperation Committee
- Some early action is advised, particularly in upgrading accounting systems to be VAT ready
## Other headlines

<table>
<thead>
<tr>
<th>China</th>
<th>Egypt</th>
<th>Australia</th>
</tr>
</thead>
</table>
| Full adoption of VAT completed on May 1, 2016 to transition away from Business Services Tax | VAT introduced in September 2016 (replacing sales tax) at 13 percent, rising to 14 percent in July 2017 | • Extension of the reverse charge rules with effect from October 2016 meaning that many nonresident suppliers of B2B services will not need to be registered for VAT  
• Introducing B2C eServices VAT regulations with effect from July 1 2017, requiring nonresident suppliers to register and account for Australian VAT. This follows a trend to tax eServices at the place of consumption |
Summary

• Significant global change requiring active engagement to understand the impact
• Accounting systems and processes will not automatically adjust to reflect the changes
• Internal change (operationally and structurally) also impacts how VAT should be managed
• For many jurisdictions VAT is a more significant source of revenue than corporate income tax
Related resources

Should you be registered for Canadian GST/HST?
This document contains general information, may be based on authorities that are subject to change, and is not a substitute for professional advice or services. This document does not constitute audit, tax, consulting, business, financial, investment, legal or other professional advice, and you should consult a qualified professional advisor before taking any action based on the information herein. RSM US LLP, its affiliates and related entities are not responsible for any loss resulting from or relating to reliance on this document by any person.

RSM US LLP is a limited liability partnership and the U.S. member firm of RSM International, a global network of independent audit, tax and consulting firms. The member firms of RSM International collaborate to provide services to global clients, but are separate and distinct legal entities that cannot obligate each other. Each member firm is responsible only for its own acts and omissions, and not those of any other party. Visit rsmus.com/aboutus for more information regarding RSM US LLP and RSM International.

RSM® and the RSM logo are registered trademarks of RSM International Association. The power of being understood® is a registered trademark of RSM US LLP.

© 2016 RSM US LLP. All Rights Reserved.