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Major changes to the Tax Code

Law no. 72/2018, Government Emergency Ordinance no. 18/2018, Government Emergency Ordinance no. 25/2018 amended recently the Tax Code on profit tax, income tax, withholding tax ("WHT"), microenterprises regime and Value Added Tax (VAT).

Common set of rules for calculating taxable profits (CCCTB), voted by the European Parliament

On 15 March, the European Parliament voted in favour of plans establishing a common consolidated corporate tax base (CCCTB), namely a common set of rules that companies operating in the EU can use to calculate taxable profits.

European Commission directives proposed on taxation of companies in the digital economy

The European Commission proposes two solutions on a long-term and on a short-term for taxation of companies with significant digital presence.

ECOFIN Agreement for the tax intermediaries' directive and for revising the list of non-cooperative jurisdictions

According to the agreement, tax intermediaries are obliged to report structures including cross-border transactions.

Decision of the Court of Justice of the European Union (CJUE) on time limits for claiming VAT refunds

VAT can be reclaimed after the statute of limitation period has expired.

Opinion of the Advocate General of CJUE on the VAT exemption for transactions concerning payments

VAT exemption denied for instructions to transfer money.

Major changes to the Tax Code

The Tax Code's major changes introduced by the Law 72/2018 for approval of the Emergency Ordinance no. 25/2017 refer to:

Corporate income tax

- A 30% deductibility threshold applied to the net loss of alienated receivables from a CIT perspective. Thus, the 30% limit shall apply to the value of the sale price less the value of the alienated receivable.
- The net loss for the assignee who now transfers a receivable is the difference between the sale price and the acquisition cost of the receivable.
- In addition, the changes address the situation of credit institutions, assigning (partially) provisioned or off-balance sheet receivables. More specifically, the amendments state that 70% of the difference between the value of the alienated receivable and the sale price should be treated as items similar to income.

Income tax

- The exemption of the income tax and social security contributions for medical services provided under a subscription, borne by the employer, is no longer applicable only to those defined as per Law 95/2006 on healthcare reform. Therefore, the costs with the voluntary health insurances and medical services provided under a subscription, borne by the employer in the limit of EUR 400/ year/ employee are not taxable from an income tax and social security perspective.
- Similarly, medical services provided under subscriptions, borne by the employee are deductible when calculating the income tax base in the limit of EUR 400/ year/ employee, regardless if they are defined or not as per Law 95/2006 on healthcare reform.
- The wording regarding medical subscriptions was amended also for the provisions of income from independent activities.

VAT exemption threshold increases

- As of 1 April 2018, the VAT exemption threshold for small enterprises will increase from RON 220,000 (EUR 65,000) to RON 300,000 (EUR 88,500).
- The following transitional measures are applicable until 31 December 2018:

Set up date of the company	Threshold to be considered
By the end of 2017	RON 220,000 – if exceeded between 1 January – 1 May 2018 RON 300,000 – if exceeded after 1 May 2018
1 January – 1 May 2018	RON 220,000 – if exceeded until 1 May 2018 RON 300,000 – if exceeded after 1 May 2018
After 1 May 2018	RON 300,000

- Taxable persons registered for VAT purposes considering the RON 220,000 threshold until 1 May 2018 can ask for deregistration, provided that, at the time of request, the new exemption threshold of RON 300,000 has not been exceeded.

Withholding tax

The deadline for submitting the annual informative return regarding the income obtained by non-residents (D207) is until 31 January (including) of the current year for the expired year, according to Emergency Ordinance no 18/2018.

Micro-enterprise tax

Certain amendments have been brought to the micro-enterprise tax through Emergency Ordinance no. 25/2018. Thus, such entities may opt to apply the corporate income tax regime if they meet certain conditions.

Common set of rules for calculating taxable profits (CCCTB), voted by the European Parliament

European Parliament legislative resolution of 15 March 2018 on the proposal for a Council directive on a Common Consolidated Corporate Tax Base (CCCTB) and on the proposal for a Council directive on a Common Corporate Tax Base (CCTB) refer to:

- Introduction of a common corporate tax base (i.e. CCTB), which is one set of rules to calculate companies' taxable profits in all EU countries. Initially, the rules would be mandatory for groups of companies with a consolidated turnover exceeding EUR 750 million. The threshold of mandatory application of the directive will be reduced subsequently from EUR 750 million to zero, over a maximum period of seven years.
- Introduction of a common consolidated corporate tax base (i.e. CCCTB), which would introduce rules for consolidation, formulary apportionment and a "one-stop shop" for tax administration.

Under the new regime, companies would calculate their tax bills by adding up the profits and losses of their constituent companies in all EU member states. The resulting tax would then be shared between member states, depending on where the profits were generated.

Some of the most important amendments brought have been highlighted below:

Important amendments to CCTB

- Introduction of the digital permanent establishment definition and several provisions to the permanent establishment specifically for digital economy;
- Exceeding borrowing costs should be deductible for a maximum of **10%** of EBITDA or for a maximum amount of **EUR 1,000,000;**
- Limitation of the carry-forward period of the exceeding borrowing costs and tax losses to five years;
- Introduction of new R&D provisions by replacing the super-deductions with a tax credit for expenses in respect to staff, subcontractors, agency workers and freelancers;
- Removal of the provisions for cross-border compensation of tax losses between subsidiaries;
- Changes to the controlled foreign companies' provisions;
- Definition of new terms such as: "economic substance", "letterbox company", "royalty costs", "transfer prices", etc.

Important amendments to CCCTB

- CCCTB's provisions shall be applied simultaneously with those of CCTB's and not in a subsequent phase, as it has been initially proposed;
- Ensuring a level playing field in the EU and mitigating the administrative burden and costs for SMEs;

- Monitoring and publication of the effective tax contribution of SMEs and multinationals;
- Modifying the apportionment formula by adding a fourth factor, 'data' factor;
- Ensuring a smooth transition to CCCTB for Member States; tasking the Commission to propose to allocate a part of CCCTB revenue to the EU budget and proportionally reduce their contributions.

Other aspects

The deadlines for the adoption and publication of the provisions of the Directive for the Member States shall be 31 December 2019 and their application from 1 January 2020.

European Commission directives proposed on taxation of companies in the digital economy

The European Commission intends to structurally change the concept of a permanent establishment (PE), in order to prevent companies operating within the EU digital services industry, from not paying or paying a tax too low on the profits earned within the country where the value of services is created, as a result of the lack of physical presence in the country where the services are performed.

Since structural changes are needed on the long-term and the implementation process is lengthy, the Commission has proposed as an intermediate solution the taxation of the gross revenues derived from digital services.

Interim tax on digital services

The European Commission is proposing a 3% digital services tax on the gross revenue resulting from the supply of certain digital services characterized by user value creation:

- Online placement of advertising;
- Sale of collected user data; and
- Digital platforms that facilitate interaction between users that then can exchange goods and services directly via the platform.

Given the specific information EU member states would need in order to levy the digital services tax, additional reporting requirements would need to be imposed. In this respect, a single EU-wide payment and reporting portal would be established, based on the one-stop-shop model currently used for VAT purposes.

Thus, businesses would be required to self-assess the tax liability and pay it on an annual basis.

Longer-term structural changes to taxation of digital services

The proposal would extend the current PE rules for digital businesses operating across borders where at least one of the following conditions is fulfilled during a tax year:

- Revenues from digital services provided to users located in a member state exceed EUR 7 million;
- Number of active users of digital services located in a member state exceeds 100,000; or
- Number of business contracts for digital services concluded by users located in a member state exceeds 3,000.

The definition of digital services would follow that used for VAT purposes under the EU VAT directive.

According to the European Commission, the structural tax changes to the PE concept should eventually be included in the proposal for a common consolidated corporate tax base (CCCTN) in order for such taxable profits to be allocated in proportion of the share of activity of an EU member state. Moreover, EU member states would also have to implement the rules on digital PEs and profit allocation for corporate income tax purposes.

In order to prevent tax avoidance, certain “Anti fragmentation” rules would be introduced.

Profit allocation

The profit allocation rules relating to digital services would be aligned with the OECD transfer pricing guidelines. The basic assumption would be that profits should be taxed where value is created. In terms of digital services, the commission intends to relate value creation to the location where the buyers of the digital services are established and data is collected and processed. Consequently, additional criteria for profit allocation would be developed, focusing specifically on digital services.

In order to apply the proposed directives, all member states should unanimously approve them. It is rather unclear when the measures would effectively be introduced, but as noted above, the Commission aims for an effective date of the interim measures starting with 1 January 2020.

ECOFIN reaches agreement on tax intermediaries directive and revises non-cooperative jurisdiction list

The new directive will provide EU tax authorities with information about cross-border arrangements in relation to individuals, companies and other entities by requiring intermediaries, such as tax advisors, accountants, banks and lawyers, who design and promote tax planning schemes for their clients, to report to the tax authorities in the country in which they are resident any cross-border tax planning arrangement they design or promote that contains specific broadly defined criteria ("hallmarks").

That EU member state will then share the information with all other member states on a quarterly basis. Intermediaries that do not comply with the transparency measures will be penalized.

The directive will be formally adopted during the next EU council meeting on 25 May 2018, and, once adopted, it will generally apply as from 1 July 2020, with limited retroactive effect.

Decision of the Court of Justice of the European Union on the time limit for claiming VAT refunds

On 21 March 2018, the Court of Justice of the European Union (CJEU) gave its decision in case C-533/16 Volkswagen AG concerning the rejection to refund VAT due to the expiry of the statute of limitation period.

Background

Between 2004 and 2010, the Hella Companies established in Slovakia supplied Volkswagen AG (VW), a company established in Germany, with moulds for the manufacture of lights for motor vehicles. They did not include VAT on the invoices as they considered them VAT exempt.

In 2010, the Hella Companies realized that the transactions were not being carried in accordance with the Slovak law and issued new invoices to Volkswagen AG, charging the VAT due for the entire period.

For the VAT paid, VW submitted a refund claim to the Slovak tax authority. The tax office partially upheld that application and ordered a refund of VAT for the

acquisition of goods carried out from 2007 to 2010. However, it dismissed the application insofar as it related to the period from 2004 to 2006, due to the expiry of the limitation period of five years provided for by Slovak law.

The CJEU was requested to rule whether VW has the right to deduct VAT charged several years after delivery of the goods, when the limitation period provided for the exercise of that right has expired before the application for a refund was submitted.

Arguments of the CJEU

As per the CJEU, the right to deduct VAT has to be exercised during the period when it occurred, namely once the VAT becomes due. At the same time, a taxable person can deduct VAT even if it did not exercise the right during the period in which the right arose.

However, the possibility of exercising the VAT refund right without any temporal limit would be contrary to the principle of legal certainty.

Even though the supply of goods at issue was carried out during 2004 to 2010, the Hella Companies did not make an adjustment of the VAT until 2010 when they drew up invoices including the VAT and paid the VAT to the state.

In these circumstances, it was objectively impossible for VW to claim VAT refund as it had neither been in possession of the invoices nor aware that the VAT was due.

Moreover, Volkswagen did not show a lack of diligence and there was no abuse or fraudulent collusion (with the Hellas companies).

Therefore, a limitation period that began from the date of supply of the goods and expired before the correction of the VAT position cannot cancel VW's right to recover the VAT.

Our views

This decision may change the existing laws from Romania.

Currently, a taxable person can deduct VAT after the right arose, but not exceeding the 5 years statute of limitation period. The only exception is the VAT assessed during tax audits. The suppliers are entitled to issue correction invoices after the tax audit and the beneficiary is entitled to deduct the corresponding VAT, even if the limitation period has expired but within 1 year from the date when the corrected invoice is received.

Based on this decision, it can be argued that the VAT recovery right can be exercised after expiration of the statute of limitation period (even for VAT not resulted from corrections after a tax audit). The circumstances of each case will be decisive; they will have to be in line with the points raised by the CJEU: late charging of the VAT by the supplier/objective impossibility of the customer to recover the VAT, diligence of the customer, non-existence of an abuse/fraud.

It would be interesting to see the time limits for exercising such VAT recovery. If the Romanian law changes, it may that the existing 1-year rule is extended.

In this context, we expect the decision of the CJEU in case C-8/17 Biosafe. The AG stated in her opinion to that case that the right to deduct the VAT arises when the invoice showing the correct VAT amount is issued and therefore, the statute of limitation should consider that date. If the CJEU follows this opinion, it would result that the 5-year statute of limitation period would need to take into account the date when the correct invoice is issued.

Opinion of the Advocate General of the CJEU on VAT exemption for instruction to pay

On 21 March 2018, Advocate General (AG) of the CJEU gave his opinion in the case C-5/17 DPAS Limited.

In brief, the AG considers that the VAT exemption for payments does not apply to instruction to pay (direct debit of a bank account for a patient that is paying his/her dentist). The fact that the instruction is essential to make the transfer of money is not sufficient to achieve that VAT exemption.

Background

DPAS provides dental plans to dentists and supplies dental plan administration services to patients (including insurance and payment management).

The operational model was as follows:

- Pursuant to a direct debit mandate, DPAS instructed the bank to transfer the agreed amount from the patient's account to DPAS account.
- DPAS then requested the bank to on-transfer the money to the dentist's bank account but withhold its service fee.

Starting with 2012, DPAS changed the structure of its services with the aim of preventing its services becoming subject to VAT based on CJEU's decision in case C-175/09 AXA.

In that case, the CJEU ruled that the services offered to dentists by AXA Denplan qualify as 'debt collection' and are therefore subject to VAT.

The change of the structure of the services consisted of the following:

- DPAS concluded contracts not only with the dentists (creditors) but also with the patients (debtors).
- The activities performed by DPAS remained unchanged though and DPAS clearly communicated that nothing will effectively change.

It seems that DPAS aimed to argue that its services cannot be debt collection as they are not provided to the creditor (owner of the debt) but to the debtor.

The UK court judging the case asked the CJEU if:

- The transfers instructed by DPAS to the banks on behalf of the patient are covered by the VAT exemption for payments.
- Such services can be excluded from the scope of taxed debt collection (and hence, be exempt) because they are performed for the debtor rather than the creditor.

Arguments of the CJEU

The AG looked at the traditional CJEU on the VAT exemption for payments: the decisive criterion for applying the VAT exemption is the changes of the legal and financial situation of the parties involved.

By contrast, the supply of a mere physical, technical or administrative service which does not result in the legal and financial changes characteristic to the transfer of money is not exempt from VAT.

DPAS is asking/instructing a payment to a bank and not actually executing the payment, i.e. debiting/crediting the bank accounts.

As such, DPAS's involvement is prior to the transfer of the money from one bank account to the other.

Therefore, such services cannot be VAT exempt even if DPAS's *involvement is essential to* performing the payment.

Moreover, in DPAS case, there are no difficulties to determine the taxable amount (this is the difference between the amounts collected from patients and the amounts transferred by DPAS to the dentist and the insurer). The purpose of the VAT exemption for financial services is to overcome the difficulties connected with determining the taxable amount and the amount of VAT deductible.

Lastly, AG takes the view that the restructuring of the contractual arrangements by DPAS in 2012 does not reflect the economic reality, which is decisive for VAT. Moreover, DPAS recognized this fact when communicating that nothing would effectively change further to the restructuring. In addition, the AG finds irrelevant who is the recipient of the services, i.e. the dentists (creditors) or the patients (debtors) are the formal recipients of the service. The economic reality of the service is the same.

Our comments

If the CJEU follows the AG's Opinion, the VAT exemption for transfers/payments would become even more limited. This is in fact the trend of the CJEU's case law of last years.

The only exempt services would be those involving actual making of the payment. Other activities intervening in the payment chain, before or after the debit/credit of the account, will be taxed.

Some companies might be quite happy with the outcome, i.e. those performing services to retailers, which benefit from VAT recovery right and generally do not have VAT as cost. Such companies may increase their VAT recovery.

The case law in the field may become even more relevant with the advent of the Revised Payment Services Directive (PSD 2) which will bring more parties to the table.

For further questions regarding the aspects mentioned in this alert, please contact us.

Dan Bădin
Tax&Legal Partner in Charge

+40 (21) 2075 392
dbadin@deloittece.com

Raluca Bontaș
Partner, Global Employer Services
+40 (21) 2075 350
rbontas@deloittece.com

Vlad Boeriu
Partner, Indirect Tax

+40 (21) 2075 341
vboeriu@deloittece.com

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