9 Maltese VAT Legislation and the EU Transitional VAT Regime

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Background

Until January 1, 1993, border controls had served as a collection point for value added tax (VAT) on the importation of goods into individual Member States of the European Community. The abolition of border controls on the movement of goods within the European Community necessitated a new mechanism to enable Member States of destination to continue to collect the relevant VAT. However, Member States came to accept that individuals who travelled to another Member State and acquired goods which they transported back to their 'home' Member State, should only pay VAT in the Member State in which the goods were purchased. Accordingly, the transitional VAT regime has been described as a hybrid system on account of the fact that while the bulk of intra-Community trade in goods is effected between VAT-registered traders and, as such, continues to be taxed in the Member State of destination, goods purchased by individuals for private consumption are, as a rule, subject to VAT in the Member State of origin.

Although the Maltese Value Added Tax Act[1] (the 'Act') embraces the basic concepts of EU VAT law, it will require a number of amendments in view of Malta's prospective accession to EU membership. The major point of divergence between the Act and the Sixth VAT Directive[2] (the 'Directive'), which is the main source of our law, is the absence from the former of the provisions of the Directive that have introduced with effect from January 1, 1993 the transitional VAT regime referred to above that is meant to operate until the origin principle of taxation is fully developed.[3] The most significant amendments to the Act will consist in the introduction of provisions to embrace the single-market concept, in particular, the introduction of provisions to regulate two new concepts of intra-Community trade obtaining under the transitional VAT regime, namely, intra-Community acquisitions and intra-Community supplies, so far treated under our law as imports and exports respectively. The concept of 'imports' and 'exports' will thus be limited to goods entering and leaving Malta from or to a non-Member State.

Identification of Taxable Persons

A main consequence of the application of the concept of intra-Community trade will be that both Maltese businesses and the Maltese VAT authorities must be able to ascertain the tax status of the parties involved in intra-Community transactions. Maltese businesses and VAT authorities will be able to make use of the EU VAT identification system, known as VIES (VAT Information Exchange System). Each taxable person should be able to obtain from the Maltese VAT authorities a confirmation of the VAT numbers of all the VAT registered persons throughout the EU. New rules will therefore be required to set up and regulate a Maltese VAT database, in respect of which, the local VAT authorities will be responsible to maintain and make available to other Member States, up-to-date information on all VAT identification numbers issued in Malta.

The VAT identification number is the key entitling a person effecting an intra-Community supply to qualify for an exemption with a right to a deduction of input tax that is attributable to that supply. In fact, it is the supplier who will be required to prove his entitlement to the exemption: first, he must ascertain the tax status of the purchaser, which must be a taxable person or a non-taxable legal person required to account for VAT on such acquisition – this is ascertained by simply obtaining the VAT number of the purchaser, hence the importance of the Community-wide identification numbers database; second, the supplier must be able to prove that

1 Act XXIII, 1998; Cap 406 of the Laws of Malta

2 Sixth Council Directive of 17 May 1977 (Directive 77/388/EEC) contains the core provisions of EU VAT legislation. This Directive provides for the harmonization of laws of the Member States relating to turnover taxes, provides for a common system of VAT and for a uniform basis of assessment.

3 At the time of writing, EU VAT legislation is based on the destination principle of taxation, that is, VAT is charged in the place where the goods and services are consumed. The original duration of the transitional period was of four years, commencing on January 1993 and ending in December 1996. However, the term has been renewed pending the Commission's proposal for the adoption of a definitive VAT system based on the 'origin principle of taxation' whereby VAT is charged in the place where the goods and services originate.

the goods have been transported to another Member State by either of the parties to the transaction.

Intra-Community Transactions

An intra-Community transaction simultaneously generates two taxable transactions: an exempt intra-Community supply in one Member State is followed by a corresponding taxable intra-Community acquisition in the Member State of destination, in the same way that an export is followed by an import. With certain exceptions, intra-Community supplies are exempt with credit in the same way as exports while intra-Community acquisitions are taxable supplies replacing the taxation at the border that otherwise applies to imports.

Intra-Community supplies

In the Member State of departure of goods, the taxable person making the supply will be exempted from VAT provided that the goods are dispatched or transported by or on behalf of the vendor or the person acquiring the goods, out of the territory of the Member State of departure but within the EU; and, provided that the intra-Community supply is made to another taxable person or a non-taxable legal person in a Member State other than that of the departure of the dispatch or transport of the goods.

Only the Member State of departure will be able to determine whether a supply has been made and whether the conditions necessary for an exemption have been fulfilled. This means that neither the Member State of departure nor the supplier will be required to ensure, in order that the supply can qualify for an exemption, that the acquisition made in the Member State of destination is in fact taxed as an acquisition. Similarly, the supplier will not be concerned with the use to be made of the goods supplied. Furthermore, it is the Member State of destination that will be required to ensure that the goods acquired will be subject to taxation and to ensure the proper exercise of the right to a deduction of the input tax by the purchaser.

Intra-Community acquisitions

Intra-community acquisitions made in Malta will attract tax in Malta and in the same way as an importation. Thus, the destination principle already embraced in our Act will be retained – VAT will still be imposed on goods that are destined for consumption in Malta. However, the Act would have to be amended to introduce the necessary abolition of import procedures for goods entering our country from an EU Member State. In fact, VAT on supplies acquired from a Member-State will no longer be due at the point of physical entry of goods in Malta but will be accounted for in the purchaser's VAT return. The incorporation of the input tax paid on intra-Community acquisitions within the domestic VAT return represents a major step towards offering a similar treatment to intra-Community and domestic transactions. VAT incurred in respect of intra-Community acquisitions will be deductible in the same way as it is deductible in respect of imports.

The Member State of destination is required to classify the transaction in accordance with its domestic VAT legislation in order to establish whether it consists of an intra-Community acquisition or otherwise, irrespective of the classification attributed to such transaction by the Member State of origin. This 'disconnection' of the classification of transactions is indispensable in restraining non-taxation. In other words, a transaction may constitute a taxable acquisition in the Member State of destination even if it not treated as a supply in the Member State of origin.

Special Arrangements

As indicated above, the transitional VAT regime is a hybrid VAT system because whereas the destination principle applies with regard to trade between taxable persons, the origin principle has been 'allowed' to apply in the case of individuals who purchase goods for personal consumption from another Member State. However, the application of the origin principle coupled with the persistence of differences in the VAT rates across Member States has created concern about distortion in trade. For this reason, the Directive provides for special arrangements with respect to certain transactions which were feared to trigger a surge in acquisitions made in Member States having low VAT rates to the detriment of Member State with higher rates.

'Distance Selling'

An individual who buys goods for personal consumption in another Member State and transports those goods to his home Member State, will only be subject to VAT in the Member State where the goods are acquired. By way of exception, the distance selling regime requires suppliers who arrange for goods to be delivered to the customer in another Member State (that is, distance selling) to register for VAT in such other Member State where the value of the sales exceed a certain threshold. The distance selling regime partly reinstates the destination principle of taxation in order to prevent distortions in trade which would arise if customers were able to choose to buy from those Member States having lower VAT rates ('rate shopping') without the inconvenience and expense of actually travelling to such Member State.

'New Means of Transport'

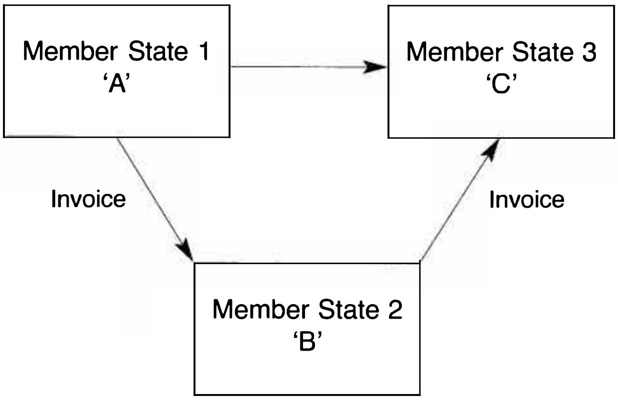
As stated earlier, the general rule under the transitional VAT regime is that if a consumer buys goods for his private consumption in another Member State and transports them to his 'home' Member State that consumer will be charged VAT in the country of purchase. However, the transitional VAT regime provides for an exception in the case of acquisitions of new means of transport. As a new means of transport represents a major purchase for the average individual and is, by definition readily transportable, a special provision has been introduced to avoid possible distortions in trade which would be caused if individuals were allowed to buy cars in Member States at the VAT rate applicable therein. For this reason, purchases of new means of transport will attract VAT at the rate applicable in the country of destination.

Some Further Implications of the Transitional Regime

Although the purpose of removing tax barriers is to provide an adequate framework for the proper functioning of the internal market, the tax treatment of intra-Community transactions and the procedures connected therewith might cause certain problems to the Maltese VAT authorities and businesses in general. Apart from the expected initial 'teething' troubles that businesses encounter when faced with a new tax scenario (amending accounting records and systems, determining acquisition events and a host of other matters), there are some potential problematic issues:

a. The retention of zero-rating on intra-Community supplies (deduction of input tax as in the case of exports) coupled with the removal of border controls effectively means that the supply to another Member State will have to be verified in other ways.
b. Unlike the case of payment of VAT on imports, VAT on intra-Community acquisitions becomes payable upon the filing of the relative VAT return and therefore becomes payable some time after the lapse of the tax period during which the acquisitions are made. This tax deferral might create a cash-flow problem for the Maltese government.
c. In case of an intra-Community transaction, where a purchaser fails to furnish his VAT number to the supplier, the latter would charge VAT at his domestic rate but the purchaser would still be liable to account for VAT on the acquisition. In such a case, it may be difficult to recover the overseas VAT once paid. Conversely, a local supplier should verify the VAT number of the overseas purchaser and must prove that the goods have actually been dispatched to the purchaser in the acquiring Member State. Otherwise the local supplier faces the risk of becoming liable to pay VAT locally.
d. Owing to the fact that VAT is no longer imposed and collected at customs point, the risk of fraud might become inherent in the system. This could easily create problems for the local VAT authorities.
e. The collation of statistical information and the setting-up and maintenance of the mandatory VAT identification database could create further administrative burdens to the local VAT authorities.
f. The removal of fiscal barriers might result in a relaxation of border controls to the prejudice of controls on the movement of illicit goods.

Finally, local businesses and the local VAT authorities will have to get accustomed to the concept of 'triangular transactions', so far alien to the Act. Triangulation occurs when the movement of goods between Member States does not follow the invoicing route. The following is a typical example: a taxable person 'C' in Member State 3 orders goods from a taxable person 'B' in Member State 2 who himself forwards the order to taxable person 'A' in Member State 1. ('A', 'B' and 'C' are taxable persons registered for VAT in their respective Member States). However, the goods are directly transported from Member State 1 to Member State 3 as illustrated hereunder:



In such a case, the transitional VAT regime provides that the intra-Community supply from Member State 1 to Member State 2 would be exempt with a right to deduction (that is, exempt with credit); 'B', in order to avoid having to register in Member State 3, issues an invoice to 'C' notifying him that he is required to account for VAT himself on the acquisition.