

VAT Proposals Jeopardize Foreign Trade

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Foreign companies selling goods in Italy under a local VAT registration may suffer huge cash flow delays as a result of new proposals making their way through the Italian Parliament.

A proposed extension of the mandatory reverse charge procedure is intended to simplify reporting requirements and comply with EU directives. However, it would also leave many foreign businesses with large VAT credits that could take years to recover from the Italian tax authorities. This undoubtedly would lead some companies to change their business arrangements or even cease trade in Italy.

While the changes have not been formally included in Italian tax legislation, the tax authorities have indicated that they will apply from January 1. The proposed changes come in addition to the EU's 2010 VAT package, which changed the rules for the place of supply of services. (For a related European Commission memorandum, see *Doc 2010-177* or *2010 WTD 3-17*.)

Conforming With Other EU Countries

Currently, foreign companies buying and selling goods in Italy generally are required to register for and charge their customers Italian VAT at a rate of 20 percent. After deducting any Italian (input) VAT incurred in buying goods or services locally, the trader must pay the net VAT to the Italian tax authorities.

During the past few years, a number of other EU member countries have introduced various antifraud measures and simplifications to the process, including shifting the collection and reporting of VAT from the supplier to the customer. Unfortunately, these changes vary in detail, adding further complexity to the EU rules. For example, in Spain the responsibility for the VAT on goods transactions is on the recipient, even if the recipient does not have a Spanish VAT number. In the Netherlands, that rule applies only if the recipient is a Dutch resident company.

Italy has now brought forward draft legislation to introduce a similar mechanism. Under the proposals, nonresident companies supplying goods locally would

no longer charge VAT to Italian resident companies. They would still be required to charge VAT to other nonresident companies and private individuals. This last category applies to the rapidly expanding international Internet retail industry, wherein the seller is required to charge local consumers Italian VAT if they pass the Italian distance-selling threshold of €35,000 per annum. These nonresident traders would still be required to pay VAT on goods and services purchased in Italy.

Under the new regime, any company selling only to Italian resident companies would almost certainly be required to deregister for Italian VAT and recover any input VAT through a claim under the EU 8th VAT Directive (79/1072/EEC).

Aside from nonresidents providing goods to other nonresident customers and private individuals, there are a number of other situations where foreign traders would not deregister, including intracommunity acquisitions and dispatches, which cover the sale of goods to and from Italy from other EU member states; and exports and imports from outside the EU.

Foreign Companies Facing Delays

Under the proposals, nonresident companies would still be charged VAT on any local purchases of goods. However, in cases where they would no longer be charging VAT, they would be left with potentially large VAT credits to be reclaimed from the Italian tax authorities. This would create a long cash flow delay because, unlike in most other EU member states, the Italian tax authorities usually take one to five years to repay VAT credits.

The VAT credit procedure in Italy is further complicated by the refund application process. A company that is registered for VAT in Italy may only request a repayment of the credit in February of the year following the receipt of the purchase invoice. A three-year bank guarantee (following a full VAT inspection) is also required from an Italian bank or authorized foreign bank for the value of the credit, plus estimated interest.

For many large corporations operating international supply-chain-type operations, this could easily result in

millions of euros being trapped with the Italian tax authorities. Many smaller traders may simply walk away from their Italian trade because the delays would make their businesses unworkable.

Nonresident companies that have to deregister would have to make claims under the 8th or 13th VAT directive to recover any Italian VAT incurred. Although the EU time limit is now 4 months (reduced from 6 as of January 1), Italian refunds still frequently take 18 months or more.

Implementation Date Uncertain

The original proposals were approved by the Senate in mid-December. Lawmakers missed the deadline for implementation on January 1, but there is widespread expectation that the proposals will be passed before the end of January.

The Tax Office, in Circular 58/E of December 31, 2009, indicated that the changes are now in force even though the legislation has not yet been updated.

Many companies, especially large supply-chain operators, are therefore reviewing strategies to avoid being left with large tax credits or refund claims. Options include forming local companies to switch to resident status, thereby permitting the companies to continue collecting VAT on sales. However, there are strict rules on permanent establishment that need to be considered, so companies should tread with caution. ♦

♦ *Sonia Piazzoni, head of TMF VAT, Milan*