

Taxation – Lecture 8

INDIRECT TAX SYSTEM: VALUE ADDED TAX (VAT) (EVIDENCE FROM THE CZECH REPUBLIC) (CONT.)

Content

- VAT – taxable supply, payment of tax, regulation and administration
- Evidence from the Czech Republic
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VAT – supply: goods and services

- **A broad-based VAT is designed to bring within its charge every kind of economic transaction, subject to limited exceptions.** This is normally achieved by drafting a **very broad provision** imposing VAT on an extremely wide range of business transactions and then removing by **specific exception** any transaction that is not to be liable. For reasons of linguistic simplicity, all the relevant transactions are termed "supplies" in most English VAT texts. However, there is no one concept of "supply" in many languages. **A more formal presentation of the scope of a VAT law** might refer to (a) **transactions involving the transfer of the legal rights to goods,** and (b) **other transactions within the scope of VAT but not involving such a transfer.**

Besides identifying what transactions are within the scope of the VAT, rules are required to determine where transactions occur, when they occur, and who for the purposes of VAT is carrying out, or treated as carrying out, the transactions.

- **Goods** - a possible definition of a "supply of goods" is **a transfer of**

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the right to dispose of tangible movable property or of immovable property other than land. A "supply of goods" is not constituted merely by a transfer of possession, which is a transfer of the use of goods, not of the goods themselves. **A transfer of the use of goods is a supply of services.**

If a transfer of possession (a supply of a service) is followed by a transfer of the title, or rights of ownership, the supply of goods is the supply of those rights and reflects the residual value after taking into account the value of the services already supplied.

Many laws also extend the definition of supplies of goods to cover supplies of energy and other kinds of supply that are similar to goods. For example, a supply of electricity is not generally treated under civil or commercial law as a supply of goods, nor is a supply of heat, refrigeration, or air conditioning. However, it is usually regarded as convenient to treat them as supplies of goods to apply the timing and location rules that relate to goods.

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"Land" in this context means the rights of a person as the owner to legal title and exclusive possession and control over any part of the surface or subsoil of the territory of the state. The emphasis is on the legal title, not on the actual soil. This may or may not automatically include legal title and possession of any buildings, structures, or equipment fixed to the surface or in the subsoil. Another point of difference in the laws dealing with land or immovable property of states is that **some states have laws under which a building on land is legally regarded as part of the land, and so cannot be sold separately from that land. In other states, a building can be sold even where the land is not sold or cannot be sold.**

- **Services** - a "supply of services" is often defined **as any supply within the scope of VAT that is not a supply of goods or a supply of land.** It may be asked **why there is any need to distinguish between "goods" and "services."** The answer is that the **rules locating a supply of services are different from those**

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for a supply of goods, as are the rules determining when such supplies occur. Further, **where VAT is charged at more than one rate, the precise identity of the supply may be critical**. Finally, **a supply of goods across the frontier of a state is an import or export of those goods and is subject to the customs regime of the state. This does not apply to supplies of services**. The latter point serves to emphasize that, in cases of doubt, it may be useful to consider the scope of the customs law of the state in considering whether or not something is a "good." **It is therefore not possible to have a supply that is not either a supply of goods or a supply of services, except for supplies of land or money**. From this, it is clear that "services" has an extended meaning. **It covers the use of all forms of property and also transfers of the right to dispose of intangible property**.

A transaction will fall within the scope of VAT under the normal rules if the transaction is a business transaction, if the person

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making the supply is a taxable person, and if some other person makes a payment for the supply.

- **Special cases of supply of services: supplies by employees and officeholders** - the law should provide that the service undertaken by an employee for the employer of that **employee does not form a supply made by that employee**. Two ways of doing this are **to expressly say so** or **to ensure that an employee can never be a taxable person**, by providing that a person is a taxable person in respect only of supplies made by that person independently.
- **Special cases of supply of services: supplies by agents** - where a supplier supplies goods or services through an agent to another person, **the supply is made not by the agent but by the supplier**. Whether in a particular case an intermediary is an agent will depend on the precise legal nature of the contract between the persons involved.

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- **Mixed supplies (goods and services together)** - in practice, it is often difficult to identify the nature of a supply. **Often what is supplied is a mixture of different things and often of both goods and services.** For example, A agrees to sell some goods to B and also to deliver them to B. A also agrees to install them upon delivery. An engineer agrees to repair B's broken machine and supplies some small spare parts while doing so.

One broad practical rule is to treat any supplies incidental to a main supply as part of that main supply. If, for example, A makes no separate charge for delivery, then the service of delivery is ignored, and the supply is taxed only as a supply of goods. If the engineer charges separately for the spare parts, then VAT should be applied separately to them.

A simple broad VAT allows many of these problems to be avoided. **If none of the forms of supply is exempt and all are subject to VAT at the same rate, then it is not as critical to separate the elements of a supply. When numerous categories of exemption are**

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allowed and more than one rate of VAT is introduced, administration becomes more complicated because much closer attention must be given to this problem.

VAT – supply: goods and services

- **Conditions:**

- **Time: goods** - the rules determining when a supply of goods takes place vary from one state to another but generally **a supply of goods takes place when:**
 - a **VAT invoice is issued** for the supply,
 - the **goods are delivered**,
 - the **goods are made available**,
 - the **goods are removed or transported** to or for the customer,
 - or the **goods are paid for** in whole or in part.

In accounting terms, these rules include both a cash basis and an accrual basis for timing a transaction. **In the interests of securing the cash-flow position of the state and of ensuring efficient collection of the VAT, it is usual to provide that the time of supply occurs when the first of these events occurs, or soon thereafter.**

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In practice, **many suppliers issue tax invoices at the time of a supply or shortly thereafter to comply with the obligation to issue a timely invoice.** The law could, for example, define the time limit as seven days after what would otherwise be the time of supply under the rules set forth above. **Where payment is made in advance of goods being delivered, the supply should be considered as taking place on the date of the payment to the extent of its amount.** The aim is to ensure that the VAT liability arises as an advance payment is made and does not await any transfer or dealing with the goods. Otherwise, advance payments could be used as a means to avoid or delay the payment of VAT. **Where only partial payment is made, portions of the amount of the supply will take place on different dates: a partial payment is treated as the first occasion of supply and the occasion for any further supplies is determined in accordance with the general rules.** This rule will apply separately to the situation where two or more payments

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are made for a supply if separate invoices are issued in respect of each payment. If one invoice is issued for the full amount due, then this will represent the applicable date for the supply for the whole sum, although payment is made in installments. **Where the "supply" of goods is actually a series of supplies occurring on a number of separate occasions, then a taxable supply occurs on each separate occasion. This is equally true for a supply of services.** For example, a customer may agree to buy from a supplier the right to set up a market stall on the supplier's land each Thursday throughout a year. A supply of the use of land in this way is a taxable supply of services. Is it one supply or a supply of the use of the land each Thursday? A technical answer to this question might refer to the precise terms of the contract under which the supplier agrees to supply the use of land in this way, including the method of payment adopted. Treating each date of supply as a separate supply achieves an efficient and practical result in that the supply is regarded as

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occurring each Thursday if payment is made for each week only after that week. If payment is made for the whole year at a set time before the end of the year, the rule about prior payment will apply. It is normally appropriate to apply the rules by reference to the terms of the agreement between the supplier and the customer.

- **Time: services - it is usual to determine the time of supply by reference to when the services have been rendered.** This is a question of fact to be interpreted in the light of any contract or agreement under which the services are supplied.

A special case that may need a different rule is that of a supply of services over a long period or a continuing supply. If a supplier agrees to supply a customer with a continuing service (e.g., a telephone service, a supply of electricity, or continuing professional assistance), the supply might be regarded as never reaching the point at which it "is performed" until the contract between the supplier and the

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customer is ended, or it might be viewed as provided every minute, which would be impractical. **However, payment is made from time to time, and the rule about partial payment can be applied.**

- **Place: goods** - often a general rule is included in the law to locate a supply of goods **where the goods are delivered or made available to the person supplied**, in other words, where they are physically handed over. **The fact that legal title does not pass at that time is not the important issue.** For goods that are being transported, a rule is needed to determine whether they are delivered at the start or at the end of the transportation. A rule that goods are delivered where the transportation starts will accord with the common commercial arrangement that goods are at the risk of the buyer while being transported. It will also ensure that the location of the supply of goods being exported is within the state. That is necessary to provide a legal basis for providing a rebate of VAT on inputs used to produce those goods.

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- **Place: services - determining the location of a supply of services can be a matter of considerable difficulty, especially for international services.** Customs rules cannot be used because they do not apply to services.
- Some aspects of the problem can be solved by **identifying separate rules for particular kinds of supply.** For example, where the services relate to land or other immovable property, it is common to treat the services as supplied where the land is situated. Beyond this, **states tend to adopt rules that locate a supply at a place of business either of the supplier or of the customer. The practical problem about locating the supply where the customer is located is imposing the VAT on that supply.** One answer to this is that of reverse charging. **A reverse-charging rule treats the customer being supplied with a service originating abroad as making the supply to itself. It must then account to its tax authorities for the VAT due as output tax on that supply.** If the customer

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pays that VAT as input tax, it can claim an offsetting deduction, and will owe no VAT. However, if the customer makes exempt supplies, then no VAT credit or deduction is available.

- **Imports - the destination principle requires a charge to VAT to be placed on all imports.** Customs regimes, such as free ports, duty-free shops, and tax-free zones can be applied readily to VAT on this basis - the zones being regarded as outside the territory of the state.

VAT – taxable and exempt supplies

- **Taxable supplies** - as previously noted, to be within the scope of VAT, a supply of goods and services must also be made (a) as part of the economic activities of the supplier, and (b) against payment (or for consideration) to that person from some other person. To complete the full definition of taxable supplies, the law must also therefore define both these criteria and determine the extent of exemption.

VAT is a tax on supplies made in the course or furtherance of economic activity, or, put another way, **as part of a business**. It should therefore be confined to activities of this nature and **not be imposed on other activities, such as the personal hobbies of an individual, gifts made for personal reasons, or charitable activities with no business or commercial content**. As a result, the law imposing the VAT usually makes it clear that **only economic activities are within the scope of the tax**. Government activity, charitable activity, and personal non-business activity should therefore be excluded.

VAT – taxable and exempt supplies

- **Payment (transfer of a consideration):**
 - **Supply with payment** - payment or consideration by both parties to the bargain, as is **a supply of goods in exchange for the provision of services by the person receiving the goods**. In addition, it does not matter who makes the payment. It will usually come from the person receiving the supply, but the **source is irrelevant**. Therefore, some laws make it clear that **all forms of payment are to be included as payment or consideration for the supply, even if this includes grants made by public authorities or other third parties**.
 - **Supply without payment** - in principle, **if there is nothing paid or payable for a supply, then it is not a taxable supply**. **Safeguards are needed to prevent the operation of this principle from allowing transactions to escape a charge to VAT in inappropriate situations**. For example, a taxable person who makes gifts of goods acquired for the purpose of the person's economic activities should be brought within the scope

VAT – taxable and exempt supplies

of the tax. Likewise, an individual trader who personally uses goods purchased for the business should also be made subject to VAT on the use. The reason for this is that the trader will have received a VAT credit (or deduction for input tax) for the goods on purchase. If there is no offsetting output tax, then there is a hidden subsidy of the trader's personal consumption and gifts.

It is therefore wise to extend the definition of supply for consideration to cover certain non-business uses of a supply. The following transactions or occasions should be considered for this purpose:

- **personal consumption by an individual of goods purchased for the individual's business**, including consumption by the individual's family and household;
- **gifts of goods, or the use of goods, made by a taxable person where the goods were purchased solely for the person's business, and the gifts are not themselves for business purposes** (e.g., advertising or trade samples); and

VAT – taxable and exempt supplies

- **supplies of goods made without charge to employees of the taxable person.**

For example, a shopkeeper who purchases food as part of her or his business but later uses the food for personal consumption might be obtaining an unfair advantage. The shopkeeper will treat the purchase of the food as a supply on which any VAT paid can be reclaimed. When the shopkeeper consumes the food, if there is no charge to VAT, the shopkeeper will have been able to obtain a credit without any charge of tax to someone else. **This rule will apply equally to the use of durable goods.**

A rule that imposes VAT on a supply for which there is no consideration must also provide a taxable value to that supply.

VAT – taxable and exempt supplies

- **Exempt supplies** - state practice on the exemption of supplies is inconsistent. Few common themes emerge. When VAT was first introduced, it was more common than it is now to apply VAT to supplies at a range of rates, including very low rates, and also to exempt a wide range of supplies. Since then, **state practice has tended to reduce the range of supplies exempted and also to cut down the range of reduced rates of VAT and to increase the levels of the lowest rates.**
 - **Effect of exemptions** - it is often assumed that "exemption" results in the reduction of the VAT burden on a supply. This is true if the person supplied is a consumer and is not receiving the supply as part of a business. It is not true if the person supplied is a taxable person. **Exemption of a supply to a business results in an increase in the burden of VAT on the supply.** The reason for this is that the person running the business can offset the VAT against the VAT charged

VAT – taxable and exempt supplies

by the business, so claiming a full rebate for any VAT. The person making the exempt supply will probably have had to pay VAT on some part of the supplies made to it and **will therefore have to pass some VAT on to the business as part of its price. It is this VAT that can be recovered if the supply is subject to tax, but that cannot be recovered if it is exempt.** To avoid the distortions caused by this failure to recover, it is good policy not to exempt the types of supply that are typically made to business.

- **Specific exemptions** - although there are strong policy arguments for minimizing exemptions, no state has succeeded in removing all exemptions from the law. Even New Zealand, which has been most successful in curbing the extent of exemptions, has maintained some:
 - **Land and buildings** - transactions involving land and buildings are commonly exempted. Many states

VAT – taxable and exempt supplies

provide that a **sale of land, or other transfer of the title to land, is outside the scope of VAT**. Other states achieve the same effect **by exempting these supplies**. Further, **the law needs to deal with supplies of services related to land**. The main service is the use of land, or leases or tenancies of land. **For the same reason that land itself is exempted, it is common to find that leases and lettings of land are also exempted.**

- **Supplies by nonprofit organizations and individuals** - many states provide exemptions for **social goods and services, that is, supplies that are made to individuals and that do not form, or do not usually form, business supplies**. An example of this is the supply of health services that are by their nature supplied to individuals. **Many social supplies are outside the scope of VAT because they are not made as part of a business or are not made for payment or consideration** (as with free health supplies from a

VAT – taxable and exempt supplies

state authority).

However, similar activities carried out by an ordinary commercial organization will not be exempt. As a result, nonprofit bodies may be tempted to engage in commercial activities in such a way as to gain unfair advantage over ordinary suppliers. It is not enough to justify exemption that those profits are used by the organization for nonprofit purposes. **For example, a religion organization that runs profit-making shops to help finance repairs to a religious building should be subject to VAT on the goods it sells.** A distinction must accordingly be drawn between the social or charitable activities of nonprofit bodies and their commercial activities.

VAT – taxable and exempt supplies

- **Financial services - exemptions of financial services are also included to avoid problems of complex administration, for example, where it is difficult to identify the value added within a transaction.** In principle, any fee or charge for a financial service should be liable to tax. **The difficulty is in identifying that charge separately from the other elements that are included when determining levels of payments of interest or fees.** Those other elements include the **real cost of the capital involved, the risk to the lender of undertaking the transaction, and the inflation rate during the transaction.** Transactions involving these elements may be termed primary financial services, and nearly every state exempts these forms of financial services for this reason.
- **Exemption of diplomatic activities - states generally have accepted treaty obligations to exempt certain supplies or imports as part of the recognition of diplomatic and consular immunities and of similar immunities for**

VAT – taxable and exempt supplies

international organizations.

- **Special categories of imports - international practice recognizes agreed categories of goods that are exempted from customs duty on import.** Practice on this is well established and **ranges from the import of a limited quantity of goods bought duty free in other states to exemption of gifts to charities or similar organizations.** It is for consideration how far those exemptions should also apply for VAT purposes. Some are appropriate because of the underlying reason for the exemption from customs duty. Others would not be appropriate because they would create unfair competition with those supplying similar goods from within the state.

One particular category of import has caused particular concern **in developing states and the economies in transition.** This is **the import of foreign-produced machinery and equipment for the use of local businesses.**

VAT – taxable and exempt supplies

In principle, such items should be subject to VAT when imported, if also subject to VAT when produced locally. **In some states, there is no local capacity to produce such items, and importers lobby strongly for VAT exemption.**

VAT – types of transaction

- Local supply, intra-community transactions, exports from and imports to EU - **See presentation from PPG “VAT”!**

Example 1

Real Spectrum, a.s., (here and after “Real Spectrum”) is developer. It provides construction and renovation services. It purchases from local and foreign suppliers and delivers its services across whole Czech Republic. Real Spectrum owns four architect and design studios in Prague, Brno, Ostrava and Olomouc.

Real Spectrum has been a quarterly VAT payer since March 2016. The following information is applicable to Fortis’s for the three-month period 1 January to 31 March 2017. If not stated otherwise the indicated amounts are states exclusive VAT.

- (1) Real Spectrum purchased wood panels and floor constructions from its vendors in Norway and Finland for total price CZK3,513,000.
- (2) Real Spectrum purchased breaks and concrete from its vendors in Poland and Hungary for total price CZK6,658,000.
- (3) Real Spectrum purchased CNC center from manufacturer from Russia for CZK1,584,000.
- (4) From Makro Cash&Carry, a.s., Real Spectrum purchased coffee, tea and water to social zone for its employees for total price CZK181,000.
- (5) From Makro Cash&Carry, a.s., Real Spectrum purchased 41 bottles of wine for CZK1,100 per bottle as Christmas gifts for its key business partners.
- (6) Real Spectrum paid advertisement fee of CZK52,000 for radio advertisements of its services for 12 months starting from October 2017 at local radio stations in Brno, Prague, Ostrava and Olomouc.
- (7) Real Spectrum purchased 25 laptops for CZK289,000 and 15 mobile phones for CZK65,000.
- (8) Real Spectrum provided bedroom renovation works for 3 customers for the following contract prices: CZK323,000, CZK211,000 and CZK315,000. All works included refurbishments and replacement of heating pipes.
- (9) Real Spectrum provided renovations of bathrooms for 3 customers for the following contract prices: CZK198,000, CZK152,000 and CZK114,000. Renovation works included supply and installation of three new baths for CZK35,000 each, three new washbasin for CZK12,000 each, and three new wall cabinets for CZK5,600 each, the remaining contract price is allocated between work and construction materials equally.
- (10) Real Spectrum delivered 18 hours of construction plans for Korda, s.r.o. for CZK5,100 per hour.

Task 1. For each of Real Spectrum’s transactions for Quarter 1 of 2017, for the purposes of value added tax (VAT) state whether:

- a) it is taxable and, if so, on what basis; or
- b) Exempt and, if so, whether exempt with or without recovery for input VAT.

VAT – payment: tax base (TB)

- **Charge to VAT - VAT is designed as a tax levied as a proportion of the value added on any taxable supply. It is therefore necessary to attribute a value (referred to as "the value") to all taxable supplies to ensure that this objective is achieved. To be consistent with the fundamental principles of the tax, the value to be taxed must reflect the value added by the supply.**

The general rule for valuing a supply for VAT purposes is to value it at the total of all payments, or consideration, that the supplier receives or is entitled to receive as a result of the supply. In other words, the value is taken as the actual realized value. All forms of payment or consideration, whether paid by the person supplied or some other person, are relevant for that purpose. They are also relevant in determining the total value.

Any distortion of the price is neutralized if both the supplier and the person supplied are fully taxable persons. Any increase or decrease in the VAT collected will then be offset by a similar

VAT – payment: tax base (TB)

increase or decrease in the VAT credit or input tax deduction claimed. The matter is only of concern if the high or low price increases the overall amount of input tax available for deduction or decreases the overall collection of output tax. This will happen only where one party is a taxable person and the other is not.

The value of a supply should be taken as including all other taxes paid on that supply. VAT is not an alternative form of excise tax or customs duty, but is a separate tax. Both customs duties and excise taxes reflect the state's separate decisions to increase the price of the dutiable and excisable products by the amount of the duty or tax. That represents the value of final consumption of the goods for VAT purposes and is therefore the basis of the value for VAT. If it is felt that the combined effect of excise duty and VAT on a product is too high, the answer lies in adjusting the level of excise duty, not of the VAT.

VAT – payment: tax base (TB)

- **FVA - where the person supplied is not a taxable person, or not a fully taxable person, but the supplier is a fully taxable person in respect of the supply, there may be a temptation for taxpayers to understate the price to avoid creating input tax that the person supplied cannot reclaim.** There are also cases where a supply is treated as being made for payment, even though nothing is paid or payable. In both cases, it may be considered appropriate to override the general rule. Instead, **value would be based on an independent measure of the value added by the transaction.** This would normally be **the open market price, or arm's-length price, of the supply.**

The open market price - or some other objectively determined price -will need to be determined in any case where a supply is treated as made for consideration although no consideration is actually paid or payable. It will also be needed in any other case where the law allows the tax authorities to override or ignore the actual price.

VAT – payment: amount

- **Two important elements remain in order to establish how much VAT the taxable person must pay to the tax authorities. The first is the rate of VAT to be paid on the value of any supply.** This deals completely with the question of determining the output tax on any supply. **The second is the offset of input tax against output tax to identify the net VAT payable.**
- **Rates** - countries' practices in setting the rate or rates of VAT have varied widely over the forty years since the tax was first introduced. **Some countries have imposed six or more effective rates at the same time.** The result has been some confusion as to the purpose of the tax and considerable administrative complexity and market distortion. Recognition of these problems, and of the underlying policy issues, has led **states to abandon complex rate structures. It is now generally accepted that the VAT should not be used as a vehicle for imposing luxury rates of indirect tax.** If a state wishes

VAT – payment: amount

to impose high rates of indirect tax on specific goods or services, then the generally easier way to do so is **with a separate excise duty or tax**. This is the usual route now chosen. Internally, it simplifies the identification of luxury goods. **Internationally, it avoids any accusation that differential rates of VAT are being used for discriminatory purposes.**

Usually VAT has a main or basic rate and one or more lower rates. The main rate of VAT is an important matter of fiscal policy in any state and the level varies significantly among states. **Arguments for lower rates concentrate on socially important goods such as food, and socially important services that are not exempted or outside the scope of VAT.** Of course, there is a cost in VAT forgone in allowing a lower rate, and **any lower rate will usually cause either the main rate of VAT to be higher than it otherwise would be, or other taxes to be higher, given the total tax revenue.** Some states have decided that it is better to collect VAT at one rate and to

VAT – payment: amount

deal with such pressures in other ways (through subsidies or adjustments in social security entitlements), while others have opted for a lower rate. Again, practice used to involve a range of lower rates but has tended to simplify toward one lower rate (as is happening within the European Union) or none.

- **Entitlement to credit for input tax** - it follows from the definition of "value added" on which VAT is based **that any VAT incurred by a taxable person as input tax should be repaid to that person in some way. The usual method of repayment is to allow the input tax to be set off as a deduction or credit against output tax collected during the same period.** A duty is imposed on the taxable person to pay only the net amount to the tax authorities. In principle, therefore, all relevant input tax incurred by a taxable person should be available for credit in this way.
- **Partial exemption** - the main category of taxable person with problems in identifying the amounts of input tax available for credit is

VAT – payment: amount

businesses that make some taxable supplies and some exempt supplies. These are often termed cases of partial exemption. If a state exempts goods of a kind available for retail purchase, then a shop or business that sells these goods and other goods will be partially exempt. **Most states exempt financial services; consequently, banks and other suppliers of financial services routinely confront the problems of partial exemption.** For example, a finance house makes supplies of financial services, which are exempt, and also supplies business advice that is subject to VAT at the main rate. The finance house is a heavy user of telephones and incurs a substantial amount of VAT on its telephone bills. **If the finance house were allowed to claim all the input tax on its telephone bills, it would be receiving excessive input tax. The law therefore allows the finance house to claim the VAT on the telephone bills that relate to its business advice services but not to its financial services.**

VAT – payment: amount

- **Disallowed input tax** - in some states all credit for input tax on cars is disallowed, sometimes with exceptions, such as for taxis and rental cars. **Input tax on vans or trucks is allowed.** Many states already have rules for income tax and other purposes distinguishing between cars and vans, and they can also be used for this purpose.
- **Bad debts** - VAT rules are designed to ensure timely payment of the VAT related to a supply. Under these rules, occasions would frequently arise when the VAT has been paid on a supply to the tax authorities, but payment for the supply is not received until a later time. In the extreme cases, more common in economies in transition, some or all of the payment will not be received at all, because the customer becomes insolvent or in some other way the debt becomes bad.

Payment of VAT to the tax authorities ahead of receipt of the VAT from the customer is a normal aspect of a VAT. This may provide a cash-flow disadvantage to the taxable person. In many states,

VAT – payment: amount

this disadvantage is not particularly significant because the taxable person benefits from a much greater cash-flow advantage that arises from holding VAT collected from some customers for several weeks before having to pay it to the tax authorities. In addition, the supplier may recover some of the economic cost of the delay in payment through an interest charge on the sums outstanding.

Allowance for bad debts - this allowance will amount, in effect, to the equivalent of input tax to offset any output tax paid to the tax authorities but not collected from the customer. If this approach is followed, a definition of "bad debt" is needed to ensure that any allowance for a bad debt does not encourage slow payment. For this reason, it is important that the mere fact of nonpayment should not make the debt bad. It should be shown that the debt is not collectable with reasonable effort on the part of the supplier, and that a minimum set time has elapsed. The length of that period will depend in part on the business practice of a state and on

VAT – payment: amount

its economy. Inflationary factors are clearly relevant, as is the usual practice for payment of bills. Where all bills are long delayed before being settled, the period for this provision will need to be longer.

VAT – procedures and administration

- **Combining VAT and customs administration on imports** - the case for combining the collection of VAT on imports of goods with the collection of customs duties is particularly strong.
- **Handling VAT on internal supplies** - there is also a strong argument for combining the administration of VAT on internal supplies with the administration of the direct taxes. In particular, many income tax payers with business income will also be taxable persons for VAT purposes. Many transactions will require review for both income tax and VAT purposes, although the ways in which income tax and VAT liabilities are calculated from that common base are radically different.
- **Regulations, instructions, and guidance** - it is impossible to set out in one law all the rules, regulations, procedures, and working practices necessary to ensure the smooth operation of a tax that can apply to several millions of transactions a day in a state. Not only does the VAT have this invasive, and pervasive, effect, but it must also take a clear enough form so that all those charged with

VAT – procedures and administration

settling transactions and issuing VAT invoices can do so with confidence and without delay. The laws, rules, and guidance must be effective, and the legislation is no more than the highest level of a multilayered system of providing rules and procedures.

- **VAT Invoices - VAT invoice is an invoice, chit, till roll print, or other document that is issued by a taxable person who makes a taxable supply and that records the supply and the amount of VAT payable on it.** The issue of invoices in the proper form is an essential part of the procedure for imposing and enforcing the VAT. **The requirement that a special invoice be issued is a feature unique to VAT. An invoice is a "VAT invoice" if it complies with the requirement of the VAT law. Invoices issued for other purposes or that do not comply with these requirements do not count as VAT invoices.**

VAT laws typically condition the allowance of a credit for input tax.

A VAT invoice is normally required to be identified as such (perhaps

VAT – procedures and administration

by having the words "VAT invoice" on it) and to contain a minimum of information about the supply being invoiced. That information would normally include:

- the name, address, and VAT number of the taxable person making the supply,
- the nature of the supply made (type of supply, type of goods or services, and quantity of goods or extent of services),
- the time the supply was made,
- the amount of payment for the supply,
- the amount of VAT,
- the name, address, and VAT number of the taxable person supplied,
- the date on which the invoice is issued, and
- the serial number of the invoice (together with identification of the printer if the invoice was purchased privately).

VAT – procedures and administration

The requirement to include all this information will make a VAT invoice a formal document. This will not be appropriate for small transactions, for example, those made by a retail store, particularly where the customer is not a taxable person. States frequently allow special simplified invoices for small transactions or for transactions recorded in a retail store in a till or cash register.

For example, in these cases, it will not be required that the details of the customer be recorded unless, perhaps, the customer wishes it. For the sake of clarity, the law should distinguish between the formal VAT invoice and simplified invoices. Only the VAT invoice will entitle the purchaser to a credit for the VAT shown on the invoice, and special procedures will apply to the VAT invoice that do not apply to simplified invoices. While the basic distinction should be drawn in the law, matters such as acceptable forms for simplified invoices are best dealt with by regulation and guidance.

- **VAT returns - the other essential document in administering a VAT is the required provision of information at regular intervals**

VAT – procedures and administration

by all taxable persons. This provision of information and the document on which the information is provided is commonly known in English as a "return." **There should be a standard form of return, so that taxable persons know precisely what is required of them and can comply more easily with the formalities of making a return, and so that the tax administration can process returns efficiently.**

All taxable persons should be required to make a return of their taxable transactions and other relevant information at predetermined and regular intervals. These intervals are called "VAT periods."

The return should cover all taxable transactions made by the taxable person during the VAT period and should show how much VAT is payable to the tax authorities for that period. The essential information on a return is therefore the following:

- **the total VAT collected on all taxable supplies made by the taxable person (output tax) in the VAT period,**

VAT – procedures and administration

- the total VAT paid by the taxable person on supplies made to the
- taxable person in the VAT period and for which a credit is allowed (the allowable VAT credit or input tax deduction),
- the amount of any bad debts to be set off against output tax in that VAT period, and
- the amount of any excess of allowable input tax over output tax in the previous VAT period that can be carried forward (allowable excess VAT credit or input tax deduction).

The requirement that a return be made for each VAT period needs to be enforceable, with a reasonably strict time limit for submission, such as within 15 days of the last day of the VAT period to which the return relates. A return should be required even if the taxable person has no taxable supplies for a VAT period. This rule allows efficient operation of systems to detect and chase after persons who are delinquent in filing.

VAT – procedures and administration

Payment of VAT - the law should also specify that all taxable persons must pay to the tax authorities at a specified time the net amount of VAT due for the VAT period (i.e., all VAT collected (output tax) less allowable VAT credit (deduction for input tax) and any allowable excess VAT credit carryover and VAT with respect to bad debts).

The duty to pay is usually on a self-assessment basis (i.e., the taxpayer itself determines the amount due by filling out the return). Each taxable person is responsible for paying the VAT due to the tax authorities in respect of any VAT period at the same time as (or, if convenient, separately but before) the return for that period is due.

Some states require advance payments of VAT, for example, three times a month, based on VAT liability for previous periods. The advance payments are then credited against the VAT due with the return.

VAT – procedures and administration

VAT periods - the payment of VAT to the tax authorities is linked to a "VAT period" as explained previously. The length of a VAT period is a policy matter for the state. **The standard period is the calendar month; often, taxable persons with small levels of taxable turnover are allowed to use longer periods of three months or a year. The VAT period should be distinguished from payment periods.** Thus, for example, a state may require enterprises of a certain size to make advance payments of VAT three times a month, while the VAT period remains a calendar month.

- **Repayment of excess VAT credit** - where the input tax credit for any VAT period exceeds the output tax collected, there is an excess of VAT credit or of deductible input tax. As a direct result, the taxable person will pay no VAT to the tax authorities for that period. However, should the tax authorities pay the difference to the taxable person? **VAT is fundamentally different from direct taxes in that it involves regular situations where a taxable person is owed money from the tax authorities.** This is an essential feature of

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VAT if it is truly a proportional tax based on regular VAT periods. The situation will arise, for example, where the taxable person buys expensive equipment or machinery costing more than the total of taxable supplies made by the taxable person during that VAT period. It also arises if the law makes provision for rebating tax to exporters.

Policymakers may be tempted to reduce or abolish the right for taxable persons to demand payments from the tax authorities, especially where state budgets are under pressure. There is an opposite temptation on political representatives to make the operation of VAT "fair" by imposing the same tight timetables on the tax authorities rebating VAT as on taxable persons paying it.

Evidence from the Czech Republic

- Value added tax is the most typical indirect tax collected not only in the Czech Republic. VAT is a tax on transactions or better a tax on consumption.
- In the Czech Republic VAT is quite a new tax (first introduced on 1st January 1993). There were a lot of changes concerning VAT in the Czech Republic because of implementation of the EU VAT directives (since 2006 - Directive 2006/112/EC).
- **In the Czech Republic a taxable person becomes a taxpayer when his turnover in the last 12 consecutive months exceeds 1 000 000 CZK. This taxable person becomes a taxpayer since the 1st day of the 2nd month after the month in which the turnover exceeds the limit.**
- **This taxable person is obligated to register as a taxpayer in 15 days after the month in which the turnover exceeds the limit.**
- **A taxable person which carries out transactions with a claim for deduction (recovery) of tax could register voluntarily.**

CR – exemptions without recovery

- **According to VAT Act of the Czech Republic the exempted transactions without recovery of input VAT are:** basic postal services, radio and television broadcasting, financial, pension and insurance activity, delivery and lease of immovable assets (amendment since 1st January 2016), health services, social assistance, education and learning etc.
- **The basic postal service** for the purposes of this Directive, is a basic service under the law regulating postal services provided by postal license holder contained in this license.
- **Radio and television broadcasting** for the purposes of exemption, means radio and television broadcast made by a broadcaster under the law, except for broadcasting of advertising, teleshopping or sponsoring.
- **Financial services** for the purposes of this Act are:
 - the transfer of securities, including book entry securities, shares in business corporations,

CR – exemptions without recovery

- accepting deposits from the public
- providing loans and cash loans,
- payment and settlement system,
- issuing payment instruments, notably credit cards or traveler's check,
- etc.
- **Pension activities** for the purposes of this Act are:
 - the provision of pension savings under the law regulating pension savings,
 - provision of supplementary pension savings under the law regulating supplementary pension savings,
 - provision of supplementary pension insurance under the law regulating supplementary pension insurance,
 - mediation of pension savings, supplementary pension saving or supplementary pension insurance.

CR – exemptions without recovery

- **Insurance activities** for the purposes of this Act are:
 - the provision of insurance,
 - the provision of ensuring,
 - services related to insurance or ensuring provided by person mediating insurance or ensuring.
- **Delivery of immovable property** – exempt from tax is supply of land that:
 - is not forming a functional unit with the structure fixed to the ground and
 - is not building land.
- **Lease of immovable property** is exempt from the tax except:
 - short-term lease of immovable property,
 - letting of premises and sites for parking vehicles,
 - the hire of safes,
 - the lease of machines or other attached devices.

CR – exemptions without recovery

- **The health services** for the purposes of this Act, is a health service under the law regulating healthcare services provided by health services specified in the authorization for the provision of health services.
- **Social assistance** for the purposes of this Act, is a social service under a special law. Social services are exempt from a tax, if they are provided under special legislation.
- **Education and learning** for the purposes of this Act, are educational and learning activities offered in kindergartens, primary schools, secondary schools, conservatories, colleges, art schools, language schools etc.

CR – exemptions with recovery

- **According to VAT Act of the Czech Republic the exempted transactions without recovery of input VAT are:**
 - delivery of goods to another Member State
 - acquisition of goods from another Member State
 - exports of goods
 - providing service to a third country
 - exemption in special cases
 - a - c : Delivery of goods to another Member State to a person registered for a VAT in another Member State (other than Czech Republic)
 - From the tax is exempt import of goods, if supply of such goods by a taxpayer in the Czech Republic was in any case exempt.
 - From the tax is exempt import of goods, if the imported goods is eligible for relief under the directly applicable regulations of the European Union:

CR – exemptions with recovery

- goods imported in consignments of a uncommercial nature,
- personal property of individuals,
- equipment, educational materials and facilities of inhabited households of pupils or students,
- transfer of business assets and other equipment when moving the business establishment,
- goods for charitable or philanthropic organizations
- etc.

CR – recovery

- **Right for recovery of input VAT (deduction of input VAT)** - the taxpayer is entitled to a deduction of input tax, for a received taxable supply, which is part of his economic activities applied as:
 - taxable supplies for supply of goods or services with the place of supply in the Czech Republic,
 - transactions, which are exempt with tax deductibility with the place of supply in the Czech Republic.

Entitlement for a tax deduction for a taxpayer arises at the moment, when the events establishing the obligation to admit the tax arise.

The taxpayer is not entitled to deduct a tax on a received taxable supplies used for the representation.

The taxpayer is entitled to deduct the full amount received by a taxable transaction, which is used exclusively for implementation of his economic activities.

- **Terms for claiming recovery** - o exercise the right of deduction, the taxpayer is obliged to fulfill the following conditions:

CR – recovery

- in respect of deductions that another taxpayer applied to him, the taxpayer is obliged to have a tax document
- in respect of deductions, which the taxpayer applied in providing taxable supply or for goods acquired from another Member State, the tax payer is obliged to admit the tax and to have a tax document
- in respect of deductions on import of goods, if the taxpayer is obligated to admit the tax according to law, the tax payer is obliged to admit the tax and to have a tax document

The taxpayer is entitled to claim a tax deduction for the first time for the taxable period, in which the conditions are met.

The right of deduction can not be applied after the deadline, which is 3 years.

- **Correction of recovery** - if a correction of tax base and amount of tax is made, which has resulted in a reduction of a claimed tax deduction, the taxpayer is obliged to correct the tax deduction.

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Correction is made by the taxpayer in the tax period, in which he has learned about the circumstances to do so.

Correction of the tax deduction is made by the corrective tax document.

- **Calculation of recovery pro rata** - if a taxpayer use a received taxable supply within his economic activities as well as for purposes unrelated to them, he is entitled to deduct tax only in proportion to the extent of his economic activities.

Part of the received taxable supply, which is used for purposes unrelated to taxpayer economic activities, are considered as supply of goods or providing of services.

This does not apply in case of fixed assets.

The corresponding deducted amount (using pro rata calculation) is calculated by multiplying the input tax for the received taxable supply with the proportion of using this supply for his economic activities.

CR – recovery

- **Calculation of recovery at the reduced amount** - if a taxpayer use a received taxable supply within his economic activities for the fulfillment with the right to deduct the tax and also on the exempt transactions without the right to deduct the tax, with the place of supply in the Czech Republic or in other country, the taxpayer is entitled to deduct only the reduced amount corresponding with the applications range of the fulfillments of the right to deduct the tax.

The respective amount of tax deductions in the reduced amount is calculated by multiplying the input tax for the received taxable transactions of which the taxpayer is entitled to deduct the reduced amount and the coefficient.

This coefficient is calculated as a percentage share of:

- numerator is the sum of the amount of tax bases and/or values with right for deduction of the tax,
- denominator is the total sum of the values in the numerator and the sum of the transactions which are exempt without the right for

CR – recovery

deduction of the tax.

Calculation of the coefficient does not include:

- sale of the fixed assets, if the assets was used for the taxpayer economic activity,
- providing of financial services, the supply of immovable property, lease of immovable property and only if they are a supplementary activity of the taxpayer.
- **Settlement of recovery** - business assets subjected to settlement, when during a period for claiming a tax deduction, the taxpayer use this property in the context of his economic activities for purposes other than those, which he took into an account, when applying the initial deduction.

The amount of the settlement of tax deduction is calculated as the difference between the right to deduct at the time of its use and the amount of the original claimed tax deduction.

CR – recovery

- **Right to recovery at registration and deregistration** - taxable person is entitled to deduct the received taxable supply acquired in the period of 12 consecutive months prior to the date, when he became payer, if the transaction is to this day a part of his business assets.

Upon cancellation of registration, taxpayer is obliged to reduce claiming of tax deduction for property that is to date of cancellation of registration his business assets for which he applied the right of deduction or portion of it.

CR – reverse charge

- **Reverse charge procedure** - in the reverse charge procedure the taxpayer, to whom a taxable transaction with the place of fulfillment in Czech Republic is made, is obliged to pay the tax on the date of chargeable event.

Taxpayer, for whom the taxable transaction of the reverse charge procedure was carried out, is obliged to correct the amount of tax in his records for the purposes of VAT. For the accuracy of calculated tax, the taxpayer is responsible, for whom the transaction was carried out.

- **Permanent use of reverse charge procedure:**
 - Delivery of gold.
 - Delivery of goods listed in annex.
 - Delivery of immovable assets.
 - Provision of construction or assembly works.

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