

FANTASIA

EXPLANATORY MEMORANDUM TO THE LAW on the VALUE-ADDED TAX

General Introduction

The Value Added Tax (hereinafter: VAT) is a method of collecting a tax on goods and services consumed within a nation, with the tax collected on imports and collected in chunks on domestic supplies as services are rendered and goods proceed through the various stages of production and distribution.

The VAT rate is applied to the amount of consideration for each taxable import and taxable domestic supply, and the supplier subject to tax can recover the VAT imposed on acquisitions used in making the taxable supplies. Thus, the taxable supplier remits tax only on the value that it adds to goods and services. An important aspect is that the deduction for input VAT is allowed right away, without waiting for the incorporation of the inputs into products.

The following example assumes a 15 percent tax rate and assumes that the sale to the final consumer is for 360, exclusive of VAT.

Example:

			Payment to Tax Admin.
Supplier of raw materials	sale	100 + 15 VAT	15
Manufacturer	sale	200 + 30 VAT	
	purchase of raw materials	100 + 15 VAT	15 (30 – 15)
Wholesale dealer	sale	280 + 42 VAT	
	purchase from manufacturer	200 + 30 VAT	12 (42 – 30)
Retailer	sale	360 + 54 VAT	
	purchase from Wholesaler	280 + 42 VAT	12 (54 – 42)
Total			54

The ultimate buyer, the consumer, suffers a total VAT burden of 15% on 360 or 54 which is the aggregate of the net VAT paid to the Tax Administration through the different stages of production and distribution [15 + 15 +12 +12].

Chapter 1

Definitions

Article 1

Definitions

This Article deals with definitions of commonly used terms in this Law. The definitions in Article 1 apply unless the context otherwise requires. The main definitions are discussed below; most others are self-explanatory. All terms used in this Law that are not explicitly defined should be interpreted within the framework of the legal system in place in Fantasia (civil law approach).

entrepreneurial activity

This term is relevant to a number of significant articles of the Law. Articles 3 and 4 provide for mandatory and voluntary registration for persons who engage in entrepreneurial activity. Article 7 provides that taxable transactions are transactions conducted in the course of a person's independent entrepreneurial activity. The place of supply of services under Article 11 generally is the location of the person's entrepreneurial activity. A tax credit under Article 20 is limited to goods or services used in a taxpayer's entrepreneurial activity.

Entrepreneurial activity is intended to cover a broad range of economic activity. It covers any industrial, commercial, banking, transport, or mining activity as provided under the Commercial Code.

export

This term is primarily relevant to the zero rating of exported goods and services under Article 17(2)(a). To qualify for zero rating, a supply must take place in Fantasia. Article 10 treats certain utility services (electric or thermal energy, gas, and water) that are exported as being provided in Fantasia.

The export, with respect to goods, involves taking the goods outside Fantasia. The export of services occurs if the services are rendered for use outside Fantasia.

import of goods

This term is primarily relevant under Article 7 to the imposition of VAT on imports of taxable goods. A person who imports taxable goods is a taxpayer under Article 2. Services incidental to the import of goods are treated under Article 9(2) as part of the imported goods. Timing rules pertaining to the import of goods are in Article 13, and exemptions for some imported goods are covered in Article 18.

The “import of goods” is defined as bringing goods into Fantasia within the meaning of the customs legislation.

permanent establishment

This term is primarily relevant under Articles 3 and 11. In determining the level of taxable transactions by a nonresident, Article 3 provides that there is included only taxable transactions carried out through a permanent establishment in Fantasia. The Article 11(2)(e) rules governing the place of supply of services treats certain services as taking place at the purchaser’s permanent establishment.

A “permanent establishment” is defined as a fixed place of entrepreneurial activities through which a person conducts those activities. The definition lists a wide variety of places that qualify as permanent establishments, including a branch, factory, workshop, as well as construction and mining sites.

person

This term is relevant to many articles of the Law. For example, taxpayers under Article 2 must be persons. Persons meeting the test in Article 3 must register. Certain persons may apply for voluntary registration under Article 4. Persons have obligations under Articles 5 and 6. A person who is registered is obliged under Article 21 to issue invoices. A customer for purposes of the Article 22 reverse taxation rule is a registered person or a resident legal person.

A “person” is broadly defined to include natural and legal persons, and all forms of associations.

taxable transactions

This term is relevant throughout the Law, but in Article 7 in particular. Under Article 7, VAT is imposed on taxable transactions and imports of taxable goods. Registration is required under Article 3 if a person conducting an entrepreneurial activity makes taxable transactions in a 12-month period exceeding the threshold in Article 3(1). Article 6 requires a person to apply for the cancellation of registration if the person ceases to make taxable transactions. A sale of a going business is not a taxable transaction if it meets the requirements in Article 8. Timing and valuation rules for taxable transactions are covered in Articles 12 and 14.

A “taxable transaction” is a transaction defined as a taxable transaction or treated as a taxable transaction under Article 7.

*Article 2
Taxpayers*

This article identifies the persons who are obliged to pay VAT, or to collect and remit it. VAT is imposed on taxable domestic supplies (taxable transactions) and on imports of taxable goods. The taxpayers are those persons charged with the obligation to remit tax on those supplies and imports.

There are three categories of persons who are taxpayers. While the expectation is that the VAT will be borne in an economic sense by final consumers, the Law imposes the obligation to collect and remit the tax on the taxpayer supplying the taxable goods and services. The first category of taxpayer is a person who is registered or is required to register (Articles 3 and 4 provide for mandatory and voluntary registration). A person is subject to mandatory registration under Article 3 only if the person conducts entrepreneurial activity and has taxable transactions in the prior 12 calendar months exceeding the EUR 20,000 threshold. The second category of taxpayer is a person importing taxable goods. The importer is a taxpayer, whether or not that person is registered or required to register. The third category of taxpayer is a nonresident who is performing services subject to the Article 22 reverse taxation regime.

The following persons are VAT taxpayers [*paragraph 1*]:

- (a) Any legal or natural person (either resident or nonresident) who carries out taxable transactions exceeding the specified threshold in the previous 12 months period [*Article 3(1)*], whether that person is registered or not.
- (b) Any person who is voluntarily registered [*Article 4*].
- (c) Any person who imports goods into Fantasia.
- (d) Any nonresident person who performs services without registering and who is subject to tax under the Article 22 reverse taxation rule.

The VAT liability commences for:

- (a) any person who is registered from the date his registration takes effect [*paragraph 2* in connection with *Article 5(3)*], and
- (b) any person who is not registered, but who is required to apply to be registered, from the beginning of the month following the month in which the person is obliged to apply for registration [*paragraph 3*].

Article 3 *Obligatory Registration*

This article identifies those persons who are required to apply for registration for purposes of VAT, and specifies the time within which the application must be filed.

A person is required to apply for registration if the person satisfies the following conditions [*paragraph 1*]:

- (a) the person carries on entrepreneurial activities; and

- (b) the person's total taxable transactions in the previous 12 months exceed EUR 20,000.

In calculating the total value of taxable transactions, a nonresident person must take into account only the taxable transactions made through a permanent establishment in Fantasia [*paragraph 2*].

If a person satisfies the requirements for mandatory registration, the person must apply to the Tax Administration before the end of the month following the month in which the conditions were fulfilled. This application must be filed by the taxpayer himself in case of a physical person, by an agent in case of a nonresident taxpayer, or by a legal representative in case of a legal person.

Article 4 *Voluntary Registration*

This article provides for voluntary registration. A person not subject to the obligatory registration may apply to be registered if the person engages in entrepreneurial activity (article 1 definition) and if the person regularly supplies at least 75% of all goods and services to registered persons. This voluntary registration gives access to the VAT credit on goods and services imported or purchased (Article 20). Small entrepreneurs who are part of the production chain will – in these situations – be able to compete with their registered competitors.

Article 5 *Registration Procedure*

This article sets out the mechanics of registration. A person applying for registration must do so in the form and manner established in regulations issued by the Ministry of Finance. This application must be completed and signed by the applicant or the applicant's legal or authorized representative. The application should be sent to the Tax Administration [*paragraph 1*].

Within 30 days after receiving an application for registration, the Tax Administration is required to register the person in the VAT register and issue a certificate of registration. This certificate of registration should contain the name, address, and other details pertaining to the taxpayer, the person's Taxpayer Identification Number (TIN), the date the certificate is issued, and the effective date of registration (i.e. the date that the tax liability commences) [*paragraph 2*].

A registration under this article takes effect (tax liability commences) on the earliest of the following three dates [*paragraph 3*]:

- (a) in case of mandatory registration [*Article 3*], the effective date of registration is the first day of the month following the month in which the obligation to apply for registration arose;
- (b) in case of voluntary registration [*Article 4*], the effective date of registration is the first day of the month following the month in which the person applied for registration; or
- (c) the date selected by the taxpayer on his application to be registered, but not before the application is filed.

The Tax Administration is required to set up and maintain a VAT taxpayer register that contains the requisite information on all persons who are registered for VAT purposes [*paragraph 4*].

If a taxpayer required to register fails to apply for registration, the Tax Administration shall register the person and send the certificate of registration required under paragraph 2 [*paragraph 5*]. In this situation the tax liability starts on the first day of the month following the month in which the obligation to apply for registration arose [*paragraph 3*].

Article 6

Cancellation of Registration

This article provides the necessary authority for a taxpayer's registration to be cancelled. A taxpayer is required to apply to cancel registration for VAT if the person ceased to make taxable supplies (in other words has ceased to make taxable transactions (section 1 definition)) in connection with entrepreneurial activities. This occurs if the person no longer makes taxable supplies of goods or services in connection with entrepreneurial activities [*paragraph 1*]. The Tax Administration may refuse to cancel registration if the applicant temporarily ceases to make supplies of taxable goods or services.

This article also provides for the voluntary cancellation of registration. A taxpayer may apply to cancel registration for VAT if the taxpayer's total taxable transactions during the previous 12 months fell below the EUR 20,000 threshold required for registration. [*paragraph 2*]. An application for voluntary cancellation of registration cannot be filed until the person has been registered for three years from the date the most recent registration became effective. This period is introduced to ensure that a person does not cancel registration soon after a voluntary registration in order to claim input VAT on purchases. This potential for abuse is also reduced as a result of the Article 7(5) clawback of input VAT on goods on hand when registration is cancelled.

The cancellation of registration under paragraph 1 takes effect when the taxpayer ceases to make taxable transactions, or for cancellation under paragraph

2, when the person applies to the Tax Administration for the cancellation of VAT registration [*paragraph 3*].

If a VAT registration is canceled, the Tax Administration must remove the person's name and other details from the VAT taxpayer register and must demand the return of the certificate of registration [*paragraph 4*].

Chapter 2 ***Taxable Transactions***

Article 7 ***Taxable Objects***

This article defines the transactions that are subject to VAT. This article imposes VAT on –

- (1) every taxable transaction; and
- (2) every import of goods, other than an exempt import [*paragraph 1*].

A taxable transaction is a supply of goods or the rendition of services in Fantasia (see Article 10 and 11) in the course of independent entrepreneurial activity [*paragraph 2*]. A taxable transaction does not include –

- (a) a supply of goods or the rendition of services that are exempt from tax under Article 18; or
- (b) the rendition of services outside Fantasia (see Article 11).

The tax is imposed on transactions in Fantasia. Articles 10 and 11 contain rules identifying the place where a supply of goods or the rendition of services takes place.

If a VAT taxpayer purchases taxable goods or services (by import or domestic purchase) and claims credit for tax on the purchase, the diversion of those goods or services for non-entrepreneurial activity is a taxable transaction subject to VAT [*paragraph 3*]. For example, this rule covers the owner's withdrawal of goods from inventory for personal use.

If a taxpayer delivers goods or renders services to his employees (including gratuitously), this supply will be treated as a taxable transaction subject to VAT [*paragraph 4*].

If a taxpayer's registration is canceled, the taxpayer is deemed to have supplied the goods on hand at the time that the cancellation takes effect in a taxable transaction that takes place at that time [*paragraph 5*].

If a person acquires goods in a taxable transaction or a taxable import, and an input VAT was denied under Article 20 with respect to such acquisition (e.g. purchase of goods related to exempt activities), the subsequent supply of those goods is not taxable [*paragraph 6*]. If a portion of the tax on the acquisition of the goods was denied under Article 20, then a portion of the supply attributable to the disallowed credit is not taxable.

Except in the case of sales at retail, the portion of the consideration for a supply attributable to a returnable container is not consideration for a taxable transaction. Since retailers will include the deposit on returnable containers in the value of a taxable transaction, the retailer may reduce the total value of taxable transactions by the deposits refunded to customers on returnable containers [*paragraph 7*].

Article 8 *Sale or Transfer of entire Enterprise*

This article treats certain transfers of a going business as a nontaxable transaction. Under this provision, the transfer of a business (or part of a business) as a going concern in a single transaction is not a taxable transaction [*paragraph 1*], provided that the following conditions are met:

- (a) the transfer occurs in a single transaction;
- (b) the transaction involves substantially all of the assets of an enterprise, or assets that constitute an independent functioning part of an enterprise;
- (c) the transferor is a registered person; and
- (d) the transferee is already, or immediately becomes as a result of the transfer, a registered person.

As a result of a transfer meeting the above conditions, the purchaser or transferee succeeds to the rights and obligations of the transferor under this Law. For example, the transferee has the obligation to pay any tax, penalty [*Article 29 and Law on Tax Administration*] or late payment interest [*Law on Tax Administration*] attributable to the tax periods before the sale or transfer [*paragraph 2*].

In deciding whether a transaction amounts to a transfer of a going business, regard must be had to its substance rather than its form, and consideration must be given to the whole of the circumstances. The vital consideration is whether the effect of the transaction is to put the transferee in possession of a going concern, the activities of which he could carry on without interruption.

The parties to the sale or transfer of a going concern are eligible to treat the supply as nontaxable only if they notify the Tax Administration in writing within 30

days of the supply of their intent to treat the transaction under this provision [paragraph 3].

Article 9 *Mixed transactions*

This article provides rules for dealing with mixed supplies; that is, a transaction in which goods and services are supplied together for a single consideration. In case of mixed transactions, the supply of goods or services that is incidental is treated as part of the main transaction [paragraph 1]. For example, the sale and installation of substantial capital equipment will involve both a supply of goods (equipment) and the rendition of services (the installation of the equipment). Where the installation is incidental to the supply of goods, the whole transaction is regarded as a supply of goods for purposes of the Law. This classification is relevant, for example, to determine when a transaction is reportable under Article 12 because the timing rules are different for supplies of goods than for the rendition of services.

If services are rendered in connection with the import of goods, these services are treated as part of the import [paragraph 2].

If a taxable transaction includes independent elements, and one or more of the elements is exempt from tax, the transaction is treated as separate taxable and VAT-exempt transactions [paragraph 3]. Likewise, if an exempt transaction includes independent elements, and one or more of the elements is taxable, the elements of the transaction are treated as separate transactions.

Example:

A doctor performs an operation and covers the wound with dressing. Because the dressing is incidental to the operation, the transfer of the dressing is not considered to be a separate taxable transaction.

Suppose that the doctor also gives the patient a one-day supply of medicine. This is again incidental to the medical service, since it is intended to make sure that the patient has medicine until able to purchase it from a pharmacy.

If the doctor gives a 10-day supply of medicine, the supply of medicine is considered to be an independent and taxable transaction, since in this case the transfer of the medicine is not incidental to the rendering of the medical service.

Chapter 3

Place of Taxable Transactions

Article 10

Place of supply of goods

This article and Article 11 provide rules to locate a supply. These rules are necessary to determine if a supply comes within Fantasia's jurisdiction to tax. This Law implements the destination principle in establishing the limits of the tax jurisdiction. Exports from Fantasia are zero-rated [Article 17(2)(a)] and imports of taxable goods are taxed [Article 7(1)]. Supplies in Fantasia are taxable transactions [Article 7(2)]. The taxation of a supply therefore depends in part on where the supply takes place.

In general, the supply of goods takes place where the goods are located at the time of delivery (in other words: where the goods are transferred). However, in case the goods need to be transported for supply, the place of supply is deemed to be the place where the goods are located when transportation starts. [paragraph 1].

A supply of electric or thermal energy, gas, or water takes place where the goods are received. If these goods are exported from Fantasia, the supply is considered to take place in Fantasia [paragraph 2]. The exports therefore are zero-rated.

Article 17(2)(b) zero rates the international transport of goods or passengers, and the supply of lubricants and consumable technical supplies for consumption during international flights. To zero rate these supplies, the Law presumes that these supplies on board a ship, aircraft or train during a transport with either departure and/or arrival in Fantasia occurs within Fantasia.

Article 11

Place of rendering of services

This article establishes rules to locate the rendition of services. The general rule is that services are rendered where the supplier of the services conducts entrepreneurial activity – where the supplier is established or maintains a permanent establishment from which the services are supplied [paragraph 1].

There are several exceptions to the above general rule [paragraph 2]:

- (1) Services directly connected with immovable property are deemed to be supplied where the immovable property is located [paragraph 2(a)].

- (2) Services connected with movable property are deemed to be supplied where the services are actually performed [paragraph 2(b)].
- (3) Services in the field of culture, art, education, physical fitness, or sports, or in another similar activity are deemed to be supplied where the services are actually performed [paragraph 2(c)].
- (4) Services connected with transportation are supplied where the transportation takes place [paragraph 2(d)]. Thus the transportation is deemed to be effected in Fantasia to the extent the transportation takes place within its borders. In order to zero rate international transportation, services related to that transportation that are rendered outside Fantasia are treated as supplied in Fantasia.
- (5) The following services are treated as rendered at the purchaser's permanent establishment that most closely related to the services:
 - (a) the transfer of ownership or concession of property right to patents, licenses, trademarks, copyright and other similar rights;
 - (b) consultations, legal, accounting, engineering or advertisement services, as well as information processing and other similar services;
 - (c) leasing of movable property (with the exception of transportation enterprises providing means of transportation);
 - (d) services of an agent finding a physical or legal person on behalf of the main party to a contract for the provision of services specified in this subpart.

Under paragraph 2, where services are described in more than one sub point, the first of those sub points applies [paragraph 3].

Example:

If a lawyer renders services involving the transfer of ownership of immovable property, the service is described in sub-points (a) and (e) of paragraph (2). According to paragraph 3, the location of the service is the location of the immovable property.

Chapter 4
Chargeable Event and Chargeability of Tax

Article 12
Time of taxable transactions

This article provides rules to determine when a taxable transaction (a supply of goods or services) occurs. The timing rules determine the accounting period in which a transaction occurs for VAT purposes, including the period in which a taxable

transaction must be reported [Articles 17 and 19], and a tax credit can be claimed [Article 20]. The time of supply dictates other consequences, such as when a tax invoice covering a supply must be issued [see Article 21].

The general rule is that a taxable transaction occurs when a VAT invoice is issued [paragraph 1]. There are two rules that may accelerate the time of the transaction to a date before the invoice is issued. First, the time of a supply may be accelerated to the date the goods are delivered or the services are rendered (or when delivery requires shipment, to the date the shipment begins), if the invoice is not issued within 5 days of those dates [paragraph 2]. Second, the time of a supply may be accelerated to the date of payment if payment is made before the first acceleration rule is triggered (payment before the date of delivery or shipment) and the invoice is not issued within 5 days after the date of payment [paragraph 3].

Example:

Suppose that an advance payment is made on March 3, goods are shipped on March 5, and an invoice is issued on March 10. In this case, because the VAT invoice was not issued within 5 days of the date of payment, the taxable transaction occurs on the date of payment, i.e. March 3.

For purposes of the rule in paragraph 3 that accelerates the time of supply to the date of payment, if there are two or more installment payments for a taxable transaction, each payment is treated as a separate taxable transaction [paragraph 4].

Example:

In the above example, suppose that the advance payment made on March 3 amounts to 100, and that the invoice is issued for 150. In this case, two taxable transactions are considered to occur: a transaction in the amount of 100 on March 3 and another transaction in the amount of 50 on March 10 (the latter transaction is considered to take place on March 10 because the invoice is issued within 5 days of the date of shipment).

The paragraph 4 installment payment rule is subject to the paragraph 5 rule governing the supply of continuous services. If services are rendered on a continuing basis, the time of the services is the date of the issuance of a VAT invoice [paragraph 5]. However, if payment for the services is made before the invoice is issued, the time of the supply is when any payment is made for the services.

If a taxpayer purchased goods and claimed an input credit for tax on the purchase, Article 7(3) treats the application of those goods or services to a non-entrepreneurial

use as a taxable transaction. Under paragraph 6, this change in use is treated as a taxable transaction when the new use begins.

A taxpayer's supply of goods or rendition of services to its employees is a taxable transaction under Article 7(4). This taxable transaction occurs when the goods are supplied or the services are rendered to the employees [paragraph 7].

When a taxpayer's registration is cancelled, the taxpayer is deemed to have supplied the goods on hand in a taxable transaction [see Article 7(5)]. This supply occurs immediately before the cancellation takes effect [paragraph 8].

Article 13 *Time of the import of goods*

This article provides the timing rule for the import of goods. An import of taxable goods takes place when the goods are entered for customs purposes. This occurs when the goods become liable to customs duty under the Fantasia customs legislation. If imported goods are exempt from customs duty, the import of goods takes place when the goods leave the control of the customs service.

Chapter 5 **Taxable Amount**

Article 14 *Value of a taxable transaction*

This article provides rules for determining the value of a taxable transaction – the value of a supply of goods or the rendition of services. The value determined under this article is then used as the basis for determining the tax payable by a taxpayer in respect of a taxable supply under Article 17. The value of a taxable supply is also relevant in determining whether a person meets the registration threshold in Article 3.

The general rule is that the value of a taxable transaction is the amount of consideration that the supplier received or is entitled to receive for the goods or services, whether from a customer or any other person (including any duties, taxes, or other fees payable, but not including the VAT) [paragraph 1].

If the consideration for a taxable supply consists in whole or in part of goods or services, the value of the taxable transaction includes the market price of the goods or services received, including any duties, taxes, or fees other than the VAT itself [paragraph 2]. If the market price of the consideration received in kind is unknown, the value of the taxable transaction can be determined by reference to the market price of the goods or services delivered.

If a person does not receive any consideration in exchange for a taxable transaction, the value of the taxable transaction is the market price of these goods supplied or services rendered [paragraph 3]. This market price rule applies when a registration is cancelled, and the de-registering person is treated under Article 7(5) as having supplied goods on hand in a taxable transaction.

In the following cases, the value of the taxable transaction for VAT is the cost price of the goods or services supplied, fulfilled, or rendered. For this purpose, the cost includes duties, taxes, or fees, other than the VAT [paragraph 4]:

- (a) the application of goods or services by the taxpayer to his own use or to use in a non-entrepreneurial activity [Article 7(3)];
- (b) the transfer of goods or services to a taxpayer's employees [Article 7(4)].

Article 15

Adjustment of the value of a taxable transaction

This article covers a number of situations where the consideration for a taxable transaction is subject to some adjustment after the supply is made, thereby resulting in a taxable person incorrectly accounting for tax on the supply. Paragraph 1 sets out the circumstances where a taxpayer must make a correction of VAT:

- (a) the transaction is cancelled in full or in part;
- (b) the nature of the transaction is changed;
- (c) the consideration is altered; or
- (d) some or all of the goods or services are returned to the taxpayer.

If any one or more of the above events occurs and the taxpayer provided a VAT invoice with the wrong amount of VAT, or the taxpayer reported the wrong amount of VAT on a VAT return, the taxpayer must make an adjustment specified in Article 19(2) or Article 20(5) for the accounting period in which the change occurred [paragraph 2].

If the VAT payable is corrected upwards, **Article 19(2)** applies; i.e. the VAT payable is in excess of the VAT reported on the invoice and the amount of the excess has to be reported as additional tax payable in the VAT return of the accounting period in which the post-sale adjustment occurs.

If the VAT payable is corrected downwards, **Article 20(5)** applies; i.e. the VAT reported on the invoice is in excess of the VAT payable and the amount of the excess can be taken into account as VAT creditable in the accounting period in which the post-sale adjustment occurs.

Article 16
Value of a taxable import

This article provides for the determination of the value of a taxable import of goods. The value determined under this article is then used as the basis for determining the VAT payable on the import under Article 17.

The value of a taxable import of goods is the customs value of the goods, determined in accordance with the Fantasia customs legislation, plus the sum of duties and taxes payable upon the import of the goods into Fantasia (not including VAT) [paragraph 1].

If services are treated as part of an import of goods under Article 9(2), the value of the services (not including VAT) is added to the value of the goods under paragraph 1 [paragraph 2].

Chapter 6
Tax Rate and Exemptions

Article 17
Tax rate

This article provides for a positive and zero rate of tax on taxable transactions, and for one positive rate of tax on taxable imports. A zero-rated supply is a taxable supply subject to a zero rate of tax. The supplier therefore can claim input VAT [Article 20] on purchases used in making the zero-rated supply.

The single positive tax rate is 15%, for both taxable transactions and taxable imports [paragraph 1].

The following taxable transactions are subject to a 0% rate [paragraph 2]:

- (a) *Export of goods or services;*
- (b) *Transportation and other services directly connected with the international transport of goods and passengers, and lubricants and other consumable technical supplies to be consumed on board international flights.*
Transportation is considered to be international if either the place of departure, the place of arrival, or both places, are outside Fantasia.
- (c) *Supply of gold to the National Bank of Fantasia.*

According to Article 18(d), gold *imported* for allocation to the assets of the National Bank of Fantasia, is exempt from VAT. Gold *supplied* domestically to the National Bank of Fantasia is zero-rated.

Article 18
Exempt transactions

This article identifies supplies that are exempt from VAT. An exempt transaction is not a taxable transaction. Tax on purchases used in making exempt supplies therefore is not creditable under Article 20.

To the extent provided in regulations, the following domestic supplies of goods and services, as well as the following types of imports of goods are exempt from payment of VAT. The exports of goods specified in this article are taxed at a 0% tax rate under Article 17(2)(a).

1. The sale, transfer or leasing of residential property or other immovable property, unless this property is used for commercial purposes (e.g. hotel or holiday accommodation) or is newly constructed residential property which has not been occupied for residential purposes for at least 2 years [paragraph (a)].
2. Financial services [paragraph (b)]. For one possible definition of financial services, see Republica VAT Act, Schedule II, paragraph 2, and Explanatory Notes to this Act.
3. The supply or import of national or foreign currency (except for that used for numismatic purposes), and securities [paragraph (c)]. The exchange of foreign currency into Fantasia currency and the reverse is not subject to VAT. The issue of coins for special occasions (e.g. commemorative) is a taxable transaction.
4. The import of gold to be transferred to the National Bank of Fantasia [paragraph (d)].
5. Religious or church-related services rendered by religious organizations [paragraph (e)].
6. Medical services [paragraph (f)].
7. Educational services rendered by educational institutions, and child care services rendered for children at pre-school institutions [paragraph (g)].
8. The supply of goods and services in the form of humanitarian aid, as well as imports of goods transferred to Fantasia state agencies and public organizations for purposes of rehabilitation after natural disasters, industrial accidents, and catastrophes [paragraph (h)].

9. Imports of goods exempt under a customs regime because the goods are not released for free circulation [paragraph (i)].

Chapter 7 ***Procedures for the Calculation and Payment of Tax***

Article 19 ***Obligation to pay***

This article provides for the calculation of tax payable by a taxpayer on taxable transactions for each accounting period. This article is not relevant for the payment of tax on imported goods because the tax payable on imported goods is paid at the time of import [Article 13]. Tax on imports and on domestic purchases is part of the calculation of tax payable for each accounting period to the extent that the tax is creditable under Article 20.

The VAT payable for an accounting period is the difference between the VAT charged on taxable transactions [Article 17(1)] and the VAT paid on imports and domestic purchases [Article 20] [paragraph 1].

Article 15 requires a taxpayer to make an adjustment under Article 19 for any underpayment of tax resulting from a post-sales adjustment. If such adjustment results in an additional VAT being payable, the additional amount is treated under paragraph 2 of this article as VAT due in the accounting period in which the post-sale event occurred. The additional tax is added to the tax payable for that accounting period under the first paragraph of this article [paragraph 2].

Article 20 ***Tax credit***

This article provides for the claiming of a credit for input tax on domestic purchases and imports attributable to the taxpayer's entrepreneurial activity [paragraph 1].

The VAT creditable is the VAT paid in respect of tax invoices issued to the taxpayer or on import documents related to the purchase of goods or services, and the import of taxable goods during the accounting period. A VAT credit is only possible if the VAT has been invoiced in accordance with the legal requirements set forth in Article 21. These invoice requirements are applied very strictly, especially if the seller did not fully account for the VAT. The credit is available for tax on goods imported during the accounting period, and for tax on purchases made during the accounting period.

The credit is available only for input tax on purchases or imports used in entrepreneurial activities. If the taxpayer engages in only taxable activities (including zero-rated transactions), all the VAT paid on purchases is creditable, irrespective of whether the costs of purchase are included into the production costs.

If the taxpayer has both entrepreneurial and non-entrepreneurial activities, the VAT credit is calculated in proportion to their use in entrepreneurial activity [paragraph 2].

Example:

A tax law professor provides some legal advice separate from his regular employment at the University. Rendering legal advice will be regarded as entrepreneurial activity, whereas his university activities (his service as an employee) will not be seen as an entrepreneurial activity. Any VAT paid on the purchase of computer equipment related to both of these activities will be creditable only in proportion to his legal advisory services.

Article 20 disallows credit for input VAT attributable to some purchases, even if they are used in entrepreneurial activities. The disallowance rules cover purchases that are subject to abuse because they have both a business and personal consumption component.

The tax credit is denied on the import or domestic purchase of passenger automobiles, unless the taxpayer's principal business is automobile sales or rental and the vehicles are used for those entrepreneurial activities. The credit also is denied for tax on purchases for entertainment or representation expenses, or for charitable or social purposes. [paragraph 3].

If the taxpayer makes taxable and tax-exempt transactions, the VAT credit must be allocated between the two categories of supplies, with the credit limited to the amount allocated to taxable transactions. The paragraph 2 rule disallowing a credit for tax on purchases and imports attributable to non-entrepreneurial activity must be applied before the rule in paragraph 4. If the supplier makes only exempt transactions, no credit is allowed.

Example:

Company A realizes a turnover of EUR 1,000,000 a year of which EUR 750,000 is turnover subject to VAT. The VAT paid on purchases amount to EUR 80,000. In this situation company A can credit only 75/100 x EUR 80,000 or EUR 60,000 of the VAT paid on purchases against its EUR 112,500 VAT liability (15% of EUR 750,000), resulting in a net VAT due of EUR 112,500 minus EUR 60,000 or EUR 52,500.

If a taxpayer is required to make a post-sale adjustment under Article 15 that results in an overpayment of VAT, the adjustment of tax must be made under paragraph 5. In this situation, the taxpayer is allowed an input credit for the amount of the overpayment in the accounting period in which the post-sale event occurred.

Article 21 *Invoices*

This article provides rules for issuing tax invoices. A person registered for VAT is obliged to issue tax invoices on all of his taxable supplies of goods or services. A person who is not registered for VAT does not have the right to issue a VAT invoice [paragraph 1].

A tax invoice must be issued in the form required by the Ministry of Finance and must contain the following information:

- (a) full name of the taxpayer and the purchaser (client), and the taxpayer's trade name, if different from the legal name;
- (b) identification number of the taxpayer, and of the purchaser, if any;
- (c) number and date of the VAT registration certificate;
- (d) name of the goods supplied or services rendered;
- (e) amount of the taxable transaction;
- (f) amount of the excise on excisable goods;
- (g) the VAT due on the taxable transaction;
- (h) the issue date of the tax invoice;
- (i) serial number of the invoice.

The above invoice requirements are enforced strictly. If one of the elements is not included, the invoice will not be treated as a tax invoice and, as a result, the purchaser will be denied the input credit.

The taxpayer must issue a VAT invoice within 5 days after the taxable transaction occurs. The time of the transaction is determined under Article 12 [paragraph 3].

In case the taxpayer supplies goods or services at retail to consumers who are not VAT taxpayers, the supplier may issue a receipt or simplified VAT invoice authorized by the Ministry of Finance [paragraph 4].

Article 22 *Reverse taxation*

This article provides for the taxation of a service rendered by a nonresident under a “reverse charge” rule. [paragraph 1]. A customer is any person who is registered for VAT in Fantasia or is a resident legal person [paragraph 2].

The customer who receives the services covered in this article is required to withhold VAT from the amount payable to the nonresident. The tax is equal to the VAT rate [Article 17] multiplied by the after-tax amount payable to the nonresident, after withholding the tax [paragraph 3].

Example:

A company in Fantasia acquires services from abroad (from an unregistered nonresident person) and pays EUR 115,000 as service fees. Assume that the tax rate on these services is 15%. The company in Fantasia has to withhold an amount equal to $15/115 \times \text{EUR } 115,000$ or EUR 15,000.

If the customer is registered for VAT, the VAT withheld is payable when the taxpayer (i.e. the customer) files the VAT return for the accounting period in which the transaction occurs [paragraph 4]. The receipt or other payment document will not satisfy the conditions for a tax invoice, but paragraph 4 treats this document as sufficient support for the registered customer to claim the withheld tax as a credit under Article 20.

If the customer is not registered for VAT, the customer must remit the VAT withheld within 30 days after the payment to the nonresident service provider was made. The withheld tax shall be paid in the manner prescribed by the Ministry of Finance [paragraph 5].

If imported property is leased by an unregistered, nonresident person to a Fantasia customer, and the lease payments are subject to VAT, with the agreement of the nonresident owner, the customer may claim a VAT credit for the VAT paid on the import. The customer will thereby be treated as the taxpayer and is liable for VAT on any subsequent supply of that property (other than its export) [paragraph 6].

Example:

A mining company exploring for minerals in Fantasia, leases drilling equipment from a foreign-based company (unregistered for VAT purposes in Fantasia). The drilling equipment is imported into Fantasia. The customs value of the equipment is EUR 2 million. The import of this equipment is subject to EUR 300,000 VAT. According to this Article, the mining company (as importer) will report this VAT due and is allowed to credit this VAT on the same VAT return. The customer is liable for VAT on any future supply (except export) of this equipment.

Article 23 *Transactions by agent*

This article provides for the taxation of transactions by an agent on behalf of a principal. Where a person (referred to as the “principal) supplies goods or renders services through an agent, the principal must account for VAT on any taxable transactions the principal makes through the agent. In fact, both the agent and the principal are liable for the tax [paragraph 1]. Whether in a particular case an intermediary is an agent will depend on the precise legal nature of the contract between the persons involved. This rule does not apply to resident agents of nonresident taxpayers [paragraph 3]. In these latter cases, the supply is considered as carried out by the agent.

The services performed and charged by the agent to the principal are, however, subject to VAT [paragraph 2].

Article 24 *Special rules*

The Tax Administration, with the approval of the Ministry of Finance, can establish rules to calculate the VAT liability for certain transactions and industries where it is difficult under the general rules of this Law to calculate the tax base and liability. The special rules can cover gambling, sales on commission, sales of second-hand goods, and transactions involving other industries. This can be done through implementation regulations to be issued by the Ministry of Finance. Some of these special cases are discussed next.

Gambling and lotteries

A gambling supply can be the supply of a ticket in a lottery or something similar. It can also be accepting a bet on the outcome of a lottery, a race, game, sporting event or other event for which there is an outcome.

The VAT is usually not worked out on the amount paid for the ticket or the bet taken, or on the value of the prizes or winnings paid out. Instead, the output tax is calculated on the operator’s margin on gambling activities, which is the difference between the total ticket sales or bets taken and the prizes or winnings paid out.

Travel agents (or commission sales)

With respect to travel agents, the VAT is aimed at the travel agents’ sales commission, which is applied to packages consisting of separate bought-in services sold to customers by travel agents in their own name. The VAT base shall be the difference between the total amount to be paid by the traveller, exclusive of VAT,

and the actual cost to the travel agent of supplies and services provided by other taxable persons where these transactions are for the direct benefit of the traveller [i.e. marginal tax base].

This regime will, however, not be applicable to services rendered by the travel agent itself. These sales are subject to the normal VAT provisions. If a single package tour contains both services rendered by the travel agent and services purchased from other taxable persons, the latter transaction shall be only subject to VAT on the marginal tax base.

Second-hand goods

If in carrying on an enterprise, the entrepreneur buys second-hand goods from an unregistered person or entity, the unregistered seller will not issue a tax invoice and will not identify any VAT buried in the price charged. For example, if the entrepreneur carries on an enterprise of buying and selling second-hand goods, he may purchase second-hand furniture from a private household. As the domestic householder who sells the goods is not registered, he does not charge VAT in the price of the goods sold. Under the general VAT rules the entrepreneur is not entitled to an input credit because the seller cannot issue a VAT invoice that lists VAT in the price he paid.

In one approach (e.g. Australia) a fictitious input credit is introduced if:

- the entrepreneur is registered for VAT; and
- the entrepreneur buys second-hand goods that he subsequently sells in a taxable transaction.

In a second approach (e.g. European Union countries) the VAT charged on the resale is based on the difference between the sales price, exclusive of VAT, and the purchase price of these goods.

Chapter 8 ***Administrative procedures***

Article 25 ***General provision***

This article provides that the VAT incorporates income tax and customs rules covering tax administration, collection and enforcement of tax, and penalties. Except as otherwise provided in this Law, certain provisions of the Law on Tax Administration (other than withholding tax at source) apply as if the VAT were an income tax. The applicable provisions relate to tax administration procedures, administrative penalties, and the collection and enforcement rules, including appeal procedures [paragraph 1].

The tax on taxable imports is to be levied and collected by Customs under the customs duty procedures in accordance with this Law and Fantasia customs legislation [paragraph 2].

Article 26
Filing of Tax Return and Payment of VAT

This article provides for the filing of VAT returns and the payment of tax due.

Every taxpayer is required to file a VAT return with the Tax Administration for each accounting period and to pay the tax due on that return [paragraph 1]. The VAT return should be filed and VAT should be paid no later than the last day of the month following the accounting period, the deadline for the filing of returns [paragraph 2]. The person who becomes a taxpayer only because he imports goods according to Article 2(1)(b) is not subject to the provisions of paragraphs 1 and 2 [paragraph 4].

Article 5(3)(c) provides that a taxpayer applying for registration can select an effective date for registration that is earlier than the effective dates provided in Article 5(3)(a) and (b), but not before the application is filed. The effective date may be before the person is registered by the Tax Administration. Paragraph 3 of this article covers this situation. It provides that the taxpayer must report and pay tax on taxable transactions that take place after the effective date of registration and can claim credit accordingly. These transactions are reportable in the taxpayer's first VAT return and are treated as taking place during the month to which the return relates. The taxpayer may issue VAT invoices for taxable transactions reported in that first VAT return.

Article 27
VAT refund

This article provides for the refund of overpaid tax, and for the cases of erroneous refunds. This article provides for a quick refund for taxpayers making substantial zero-rated transactions. If at least 25 percent of a taxpayer's taxable transactions in an accounting period are taxed at a zero rate (see Article 17), then upon application for refund by the taxpayer, the Tax Administration (from its appropriate budget) shall immediately refund the excess of tax credits over tax charged for the accounting period [paragraph 1]. The request has to be filed together with the VAT return for that accounting period [paragraph 1].

Example:

Assume that Company A has a taxable turnover of EUR 100,000 in January 2003 which contains EUR 60,000 taxed at 0%. Assume that the VAT creditable amounts to EUR 10,000 on purchases during this

accounting period. As the turnover taxed at 0% is 60% of the total taxable turnover, Company A can apply for an immediate refund of excess VAT according to Article 27(1): VAT payable (i.e., 15% of EUR 40,000 or EUR 6,000) minus VAT creditable (i.e., EUR 10,000) or EUR 4,000.

If Company A had a taxable turnover of EUR 300,000 in January 2003, however, it must carry forward its excess VAT credits to the next five accounting periods as described below.

In all cases other than the one just described above, if a taxpayer files a return for an accounting period reporting credits in excess of VAT chargeable, the taxpayer must carry forward the excess to the next five accounting periods as a credit against tax payable. If after the end of the next five monthly periods, there are unused credits from the first accounting period, the excess credits remaining are immediately refundable from the appropriate budget [paragraph 2].

Example:

Assume that Company A has the following VAT history:

Month	VAT payable	VAT creditable	VAT carryover	VAT due
October 2002	20,000	55,000	- 35,000	0
November 2002	10,000	15,000	- 5,000	0
December 2002	15,000	10,000	+ 5,000 (Oct. '02)	0
January 2003	20,000	20,000	0	0
February 2003	22,000	20,000	+ 2,000 (Oct. '02)	0
March 2003	25,000	22,000	+ 3,000 (Oct. '02)	0
April 2003	25,000	15,000	+ 5,000 (Nov. '02)	5,000

Immediately after 31st March 2003 Company A will be entitled to receive in cash a EUR 25,000 refund for the excess credit from October 2002. The full amount of VAT excess of November 2002 was credited in April 2003.

If it is established that the Tax Administration refunded tax erroneously, the Tax Administration may demand the return of the refunded amount according to the procedures for the collection of tax due [paragraph 3].

Article 28
Responsibility and control

The taxpayer or his representative must comply with the rules covering the calculation and payment of VAT, as well as the rules governing the filing of the return with the Tax Administration by the prescribed deadline. If VAT is to be collected by the customs agencies, the taxpayers or his representative must comply with the relevant customs legislation that applies to such collection [paragraph 1].

The VAT is administered by the Tax Administration and customs agencies to the extent that each is responsible for such administration. They must administer the VAT in accordance with the Law and the customs legislation in Fantasia, as the case may be [paragraph 2].

If after an examination, the Tax Administration determines that the taxpayer has understated the tax due, the Tax Administration may issue an assessment. Generally, an assessment must be issued within 5 years after the end of the accounting period to which the assessment relates. There is one exception. If the understatement is due to fraud, the assessment may be made at any time [paragraph 3].

Chapter 9 ***Penalties***

Article 29 ***Special VAT Penalties***

This article provides for penalties for violations of the Law.

With respect to the following more serious violations of VAT, a 100% penalty is imposed:

1. If a person is required to register and fails to register, the penalty is 100% of the tax payable for the period of operation without registration [paragraph (a)].
2. If a person fails to issue an invoice required to be issued, or issues an improper invoice that reduces the tax payable or increases an available credit, the penalty is 100% of the understated or overstated tax on the transaction or the tax reportable on the unissued invoice [paragraph (b)].
3. If a non-registered person issues a tax invoice without transferring the VAT due to the Tax Administration account, the penalty is 100% of the tax indicated on the invoice.
4. If a person improperly collects VAT, the penalty is 100% of the amount of VAT collected.

Chapter 10 ***Appeal procedure***

Article 30 *Appeal*

This article provides for the objection to an assessment and appeal to the Tax Appeal Commission. Appeals from the Tax Appeal Commission are governed by the Law on Tax Administration [paragraph 3].

A person dissatisfied with an assessment by the Tax Administration under Article 28 may object to the assessment by appealing to the Tax Appeal Commission. The appeal must be filed with the Tax Appeal Commission within 30 days from the receipt of the assessment, and the person filing the appeal must deposit 50% of the additional tax assessed in cash in a designated account of the Tax Administration [paragraph 1].

If the taxpayer does not appeal an assessment by the Tax Administration within the 30-day period, the assessment is deemed to be correct and final and the amount assessed is immediately payable to the Tax Administration. [paragraph 2].

Chapter 11 *Transitional provisions*

Article 31 *Creditable sales tax*

This article provides for a credit under Article 20 for sales tax paid on qualifying goods on hand that were purchased before the VAT becomes effective.

As a transitional rule, to the extent provided by regulations, the sales tax paid on qualifying goods on hand when this Law enters into force is creditable under Article 20. The provision is limited to the sales tax paid on goods that were acquired in the six-month period before this Law enters into force.

Chapter 12 *Final provisions*

Article 32 *Regulations*

This article provides for the issuance of regulations by the Ministry of Finance.

Some of the provisions require more detailed implementation regulations (e.g. administrative procedures, practical approaches to special situations – lotteries, etc.). The Ministry of Finance is charged with the responsibility and authority to issue the regulations needed to implement this Law.

Article 33
Entry into force

This Law shall enter into force after the appropriate democratic procedures have been followed and publication has been followed, but not earlier than [.....] [paragraph 1].

As registration has to start before the introduction of the VAT, the provisions governing registration have to be entered into force at an earlier stage to allow the Tax Administration to be prepared for the proper implementation of the VAT. The provisions concerning registration apply as of [4 months before this Law enters into force][paragraph 2].