

# TaxAlert

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## How will the financial services sector be affected by the amendments of the VAT Law

As of 1 January 2010 the VAT Law will have a service exemption for “financial services” instead of the currently applicable institutional exemption for “banks, insurance companies and similar”. This change will have significant impact on the way the financial services sector i.e. banks, insurance and reinsurance companies, leasing and credit card companies will operate.

Financial and insurance services will now be exempt from VAT regardless of who provides them (banks, insurance companies or any other entity) - this will have an impact on the VAT recoverability rate for all entities providing financial and insurance services.

Banks, insurance companies and other financial institutions will no longer be VAT exempt purely on the basis of their legal status. Should such companies provide services that are subject to VAT, they will need to register for VAT, both charging VAT but also recovering input VAT.

On the other hand, a difference to the current status is that leasing and credit card companies will be partially

exempt from VAT whereby the VAT exemption will be applied to those services with a financial character. By becoming partially VAT exempt, they will no longer be entitled to a full recovery of their input VAT which will represent an additional VAT cost.

### The VAT Law provisions

As of 1 January 2010 the provisions of the VAT Law defining financial services will be harmonised with the EU VAT Directive. The VAT Law will state that insurance and reinsurance transactions, transactions in relation to credits, savings and current accounts, currencies, banknotes and coins, specific transactions in relation to shares, other equity interests in companies and debt securities will qualify as financial services on which VAT does not have to be assessed, that is, these services will qualify as VAT exempt services (with no input VAT recovery possible).

On the other side the following services should be considered as non-financial whereby the provider will be obliged to charge VAT:

- certain leasing and similar rental services
- safe deposit box rental

- advisory and legal services
- securities management services
- certain factoring activities
- management of custodial accounts
- assessment of credit worthiness
- valuation services
- administrative services

The provider of these services will have the right to recover input VAT incurred in relation to the above services and will have the right to recover input VAT on a proportion of overheads.

### Issues

By introducing a financial services exemption instead of the existing institutional exemption the following issues need to be considered by companies to determine their exact VAT status and to assess the VAT cost or benefit to them from the new law:

- classification between “VATable” and exempt deliveries
- determining whether the value of non-financial “VATable” deliveries exceeds the VAT registration threshold of HRK 85,000 annually

If an entity is required to register for VAT purposes, the registration for VAT will bring additional obligations but also additional rights:

- the entity will be obliged to issue proper VAT invoices and to comply with all VAT documentary requirements, such as maintaining VAT books
- the entity will have the right to deduct input VAT on incoming invoices on all purchases made after 1 January 2010 relating to "VATable" supplies; however, in order to exercise this right the following questions need to be answered:
  - is the input VAT incurred related to the provision of "VATable" or exempt deliveries?
  - is the entity from which the invoice is received registered for VAT?
  - does the incoming invoice have all elements required by the VAT Law?
  - are other conditions for input VAT recovery fulfilled?
  - were purchases incurred before or after 1 January 2010?

Given that the above rights and obligations create a need for additional procedures to be implemented within the company it is necessary to adjust the IT system in order to be able to account for VAT;

prepare VAT required documentation; determine input VAT that can be claimed back and to communicate with both suppliers and clients on changes required in processes to ensure compliance with the new legislation.

### How can KPMG help?

We offer combined teams of VAT experts (with local and EU expertise) and industry sector specialists who know your business. We therefore know where best to focus your efforts in order for you to achieve the most from these new and demanding VAT requirements i.e. to comply with the VAT legislation, and more importantly, to optimise your VAT recovery position or minimise your VAT exposures.

We would be happy to cooperate on:

- providing assurance that you are in compliance with the legislation and that you understand its full impact
- designing and implementing a new system which will facilitate the optimisation of your VAT recovery rate through testing and evaluating alternative methodologies and determining how these could assist the overall VAT recovery position (based on defensible methods applied throughout the EU)
- developing automated processes in order to achieve significant reductions in the time required to complete VAT

returns and increase the overall level of control over the process (this would result in decreasing the total cost of compliance and the level of potential human errors)

- establishing an effective platform that would be flexible to potential changes due to frequent VAT legislation amendments (the recent increase in the VAT rate from 22% to 23% is an example)
- training of individuals to ensure a smooth transition and to achieve the appropriate and required level of VAT knowledge of all employees
- achieving not only compliance with the new rules but also striving towards cash and cost optimisation

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