March 2025

New VAT exemption rules

for small businesses operating in the EU

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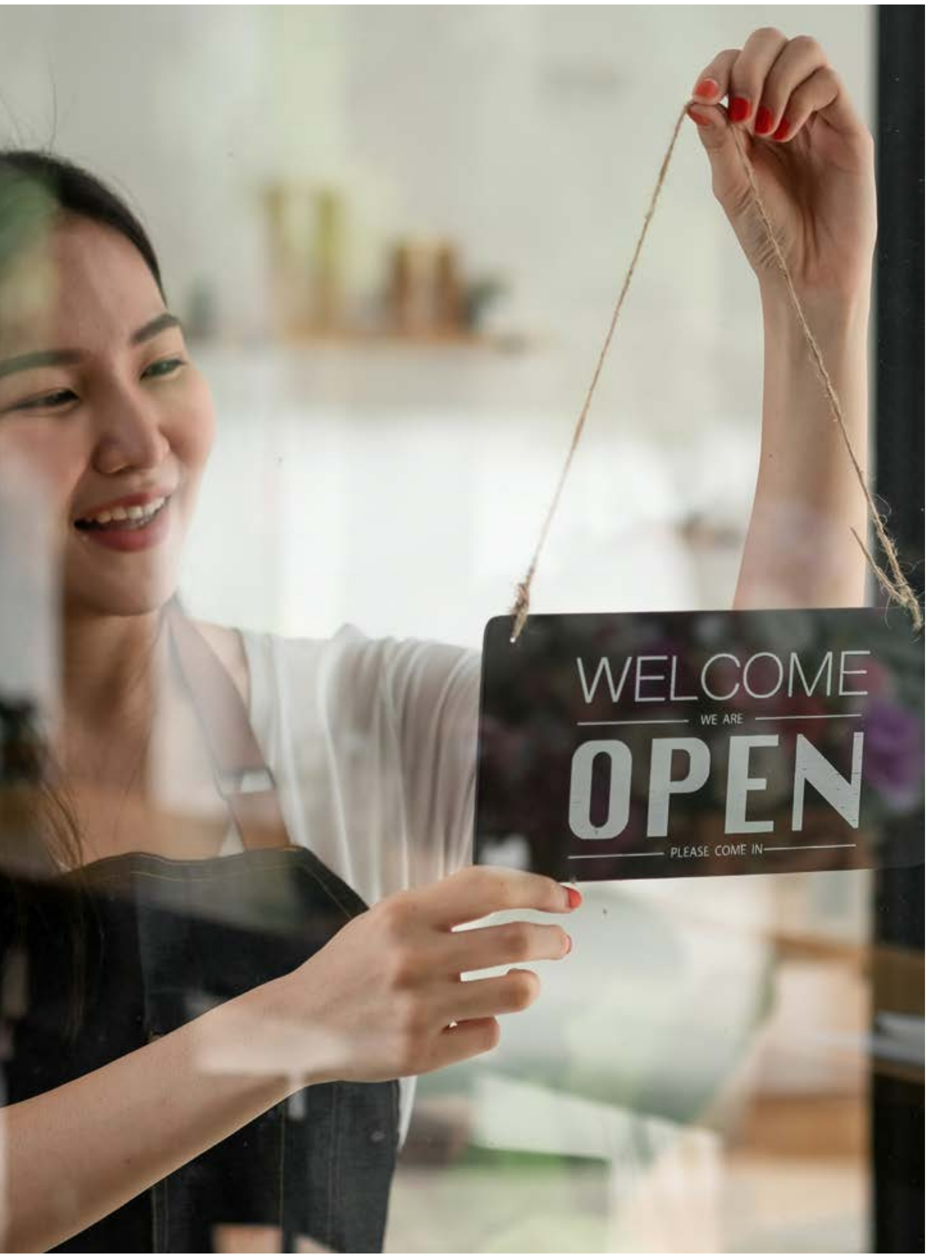
New regulations on VAT exemptions for small businesses operating in the EU went into effect at the start of 2025. They are meant to simplify procedures and reduce the administrative burden for traders conducting cross-border activities. The most important change is the ability to, on certain conditions, apply the VAT exemption not only in the company's state of establishment, but also in other EU member states.



New VAT exemption procedure in effect as of 1 January 2025

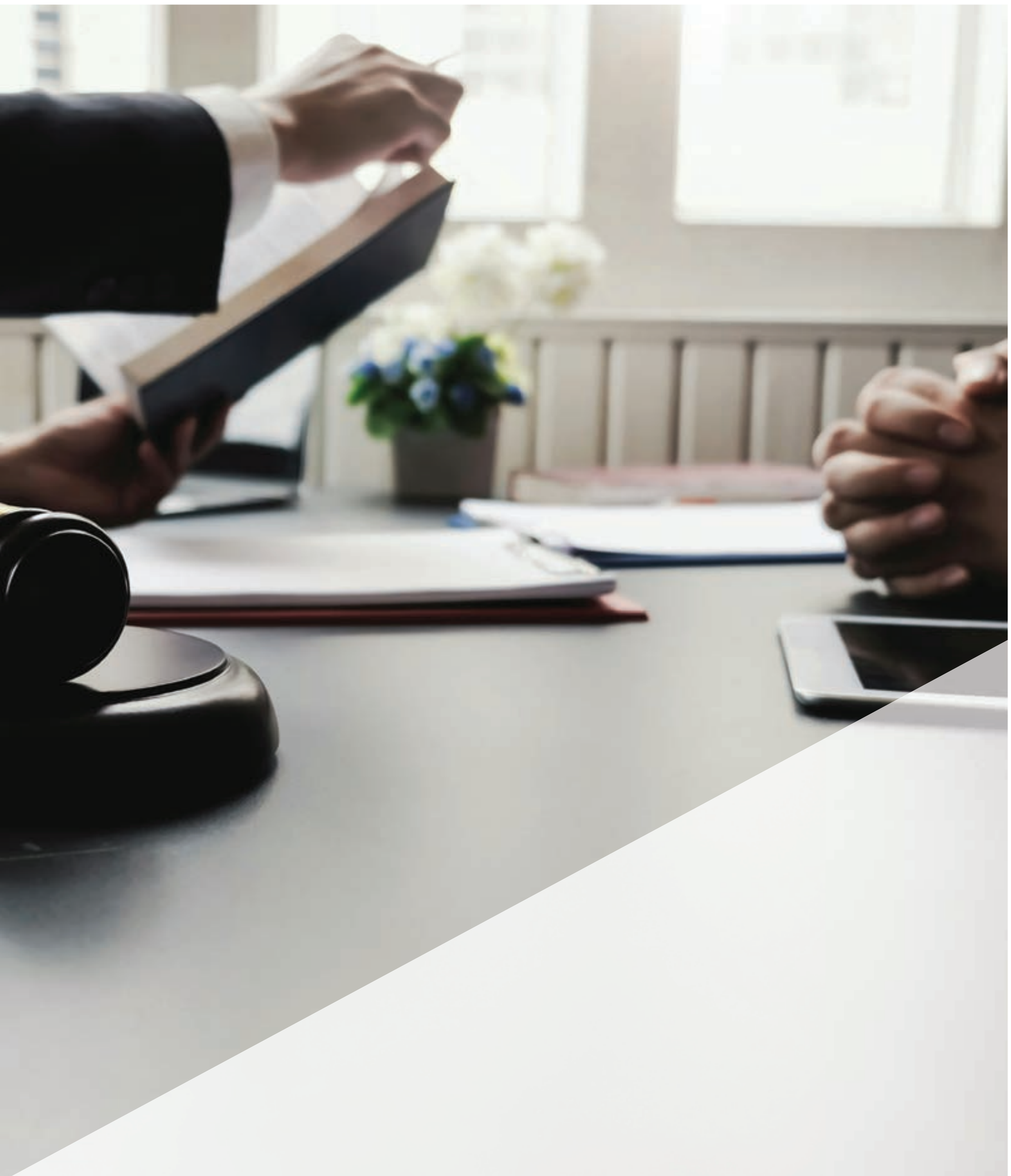
The SME (Small Medium-sized Enterprise) procedure was introduced based on Council Directive (EU) 2020/285 of 18 February 2020, and in Poland implemented by the Act of 8 November 2024 on amending the Value Added Tax Act. As of 1 January 2025 these regulations allow small businesses to benefit from a VAT exemption in member states other than their state of establishment. Under the previous system companies had to register for VAT in each state they operated. The procedure is meant to reduce the administrative burden for small businesses conducting cross-border activities. Traders have the option to choose the procedure. This means that they can, but do not have to apply it. It is up to the trader to use it or not.

Application of new procedure after specific conditions met

To apply the SME procedure, a business must meet a number of key conditions. The most important is to not exceed the annual turnover totaling 100 000 euro in all EU member states (in the current and previous tax year). In addition, the company must comply with the local VAT exemption limits in the different states (e.g. in Poland it is PLN 200 000). It must not conduct activities in sectors excluded from the exemption in a given state. The state in which the company wants to apply the exemption must also have implemented the SME procedure, as not all member states have done so. The 100 000 euro limit is not calculated in proportion to the period of business operations. Translation of the values expressed in foreign currencies into PLN is to be made using the exchange rate published by the European Central Bank on the first day of the tax year. Some member states also require disclosure of the turnovers for two years preceding the prior notification.

Uniform identification system as part of SME procedure

A special tax identification system has been introduced as part of the SME procedure. After submitting prior notification and meeting the conditions, the business is assigned an individual identification number with an EX code (e.g. for a Polish company the format is PL[NIPnumber]-EX). The number is used solely for SME procedure purposes and does not replace the VAT-EU number. Importantly, a company can have an EX number and be registered for VAT-EU at the same time. The validity of an EX number can be checked on a special EU SME-on-the web platform, which has been accessible since 1 January 2025. For taxable persons exempt from VAT in Poland, but registered for VAT-EU, the heads of tax offices update their status to "exempt VAT taxable person" ex officio when they choose SME and add this information to the so-called white list.

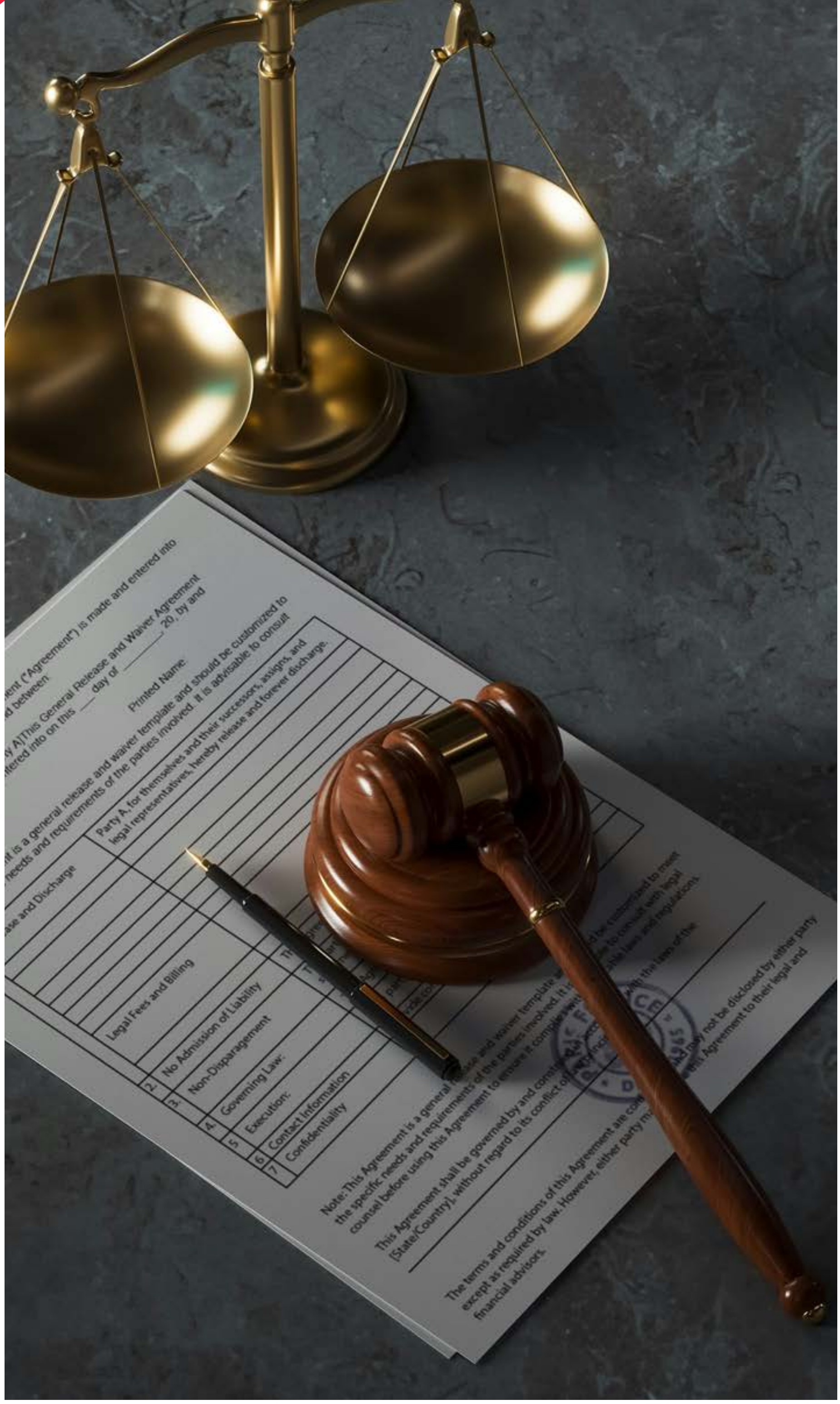


New procedure and VAT OSS can both be used under certain conditions

The SME procedure and the VAT OSS system are mutually exclusive in the same member state, as VAT OSS relates to registration for VAT, whereas SME means exemption from VAT. However, a business can simultaneously apply the SME procedure in some states, while applying VAT OSS in others. This is of particular significance when the exemption thresholds are exceeded in different states. For example, a company may be exempt from VAT in Germany and France (SME), while at the same time applying VAT OSS in the Czech Republic. The system is flexible and can be adapted to the company's individual needs. It should, however, be noted that the SME mechanisms and accounting for services using the reverse charge procedure (import of services) have different scopes of application and are mutually exclusive. To recap, VAT OSS (VAT One Stop Shop) is a procedure that lets traders account for VAT on B2C (business-to-consumer) transactions in one EU member state instead of separately registering for VAT in each state they conduct sales.

Cross-border operations must be properly reported

The first key obligation under the SME procedure is proper registration and notification. The business must submit a so-called prior notification to the Head of the Second Tax Office Warszawa-Śródmieście (for Poland). The notification should list all the states in which the business intends to apply the exemption, as well as provide EU annual turnover information. The document must be submitted electronically through the e-Tax Office system. The original prior



notification must be updated in the event of changes to the company's operations. This is a fundamental component of the procedure that is a condition of eligibility for the exemption. The tax office has 35 working days to make a decision after the prior notification is received, extendable if an additional verification is required.

Regular reporting is required

The second important obligation is to regularly submit quarterly information. Traders registered for the SME procedure must submit reports within a month of the end of each quarter (e.g. in Poland they submit quarterly SME_IK information). In the reports they indicate the value of quarterly turnover in EUR in each member state, including the value of sales in the state of establishment. The quarterly information filing deadline cannot be exceeded and cannot be extended even if it falls on a holiday. Errors require the submission of a correction. Failure to fulfil this obligation can result in a loss of eligibility for the exemption. If the EX number was assigned in a quarter following the submission of the so-called prior notification, the trader must submit quarterly information for the quarter in which the notification was submitted, as well as for the subsequent quarters preceding the assignment of the EX number.

System requires ongoing monitoring of turnover limits

The third key obligation is to continuously monitor turnover limits. Traders must keep track of both the overall Union limit (100 000 euro), as well as the individual member state limits. If the Union limit is exceeded, the company will have only 15 working days to submit special quarterly information for the period from the start of the quarter to the day on which the threshold was exceeded. Exceeding any of the limits results in losing eligibility for the exemption – in the case of the Union limit the business loses eligibility in the entire EU, and in the case of a state limit - in the given member state. Where the limit is exceeded in a state, the trader can consider registering for VAT locally or applying the VAT OSS procedure.

Application of procedure leads to specific legal consequences

Application of the SME procedure involves certain restrictions and consequences. The most important is losing eligibility to deduct VAT on goods and services used as part of exempt supplies. This means that a business cannot deduct input VAT on purchase invoices related to exempt sales in other member states. In addition, when opting out of the exemption, the effective date is strictly defined and depends on when the opt-out request is submitted. The trader must carefully analyze whether the benefits of the exemption outweigh the related restrictions. An opt-out becomes effective as of the first month of the quarter following the quarter the opt-out request was submitted – if submitted in the first or second quarter, or as of the second month of the following quarter – if submitted in the last month of the quarter.

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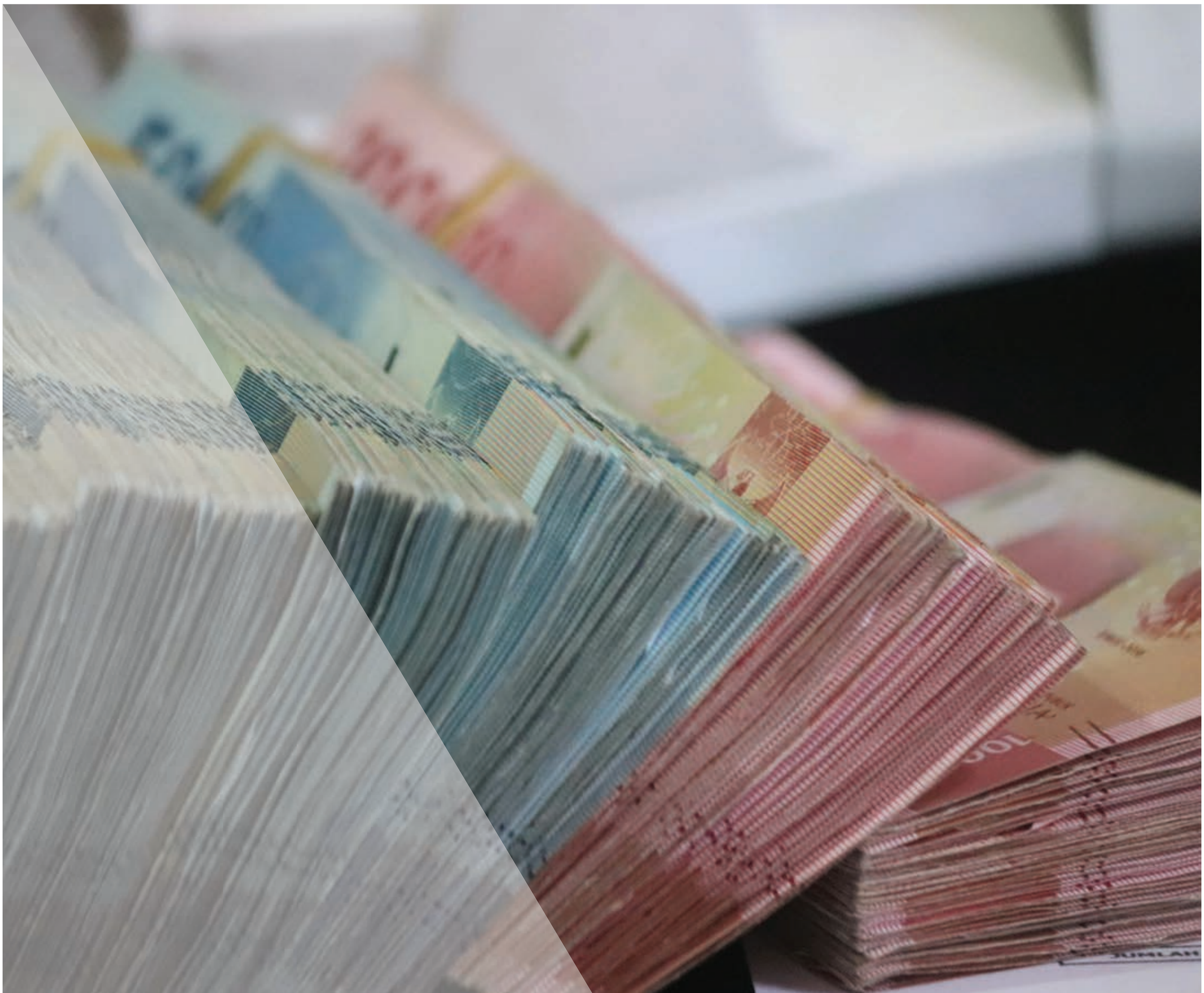
SME procedure implementation requires professional expert support

Implementation of the SME procedure poses a number of challenges that require specialized knowledge. The key areas where the support of experts may turn out useful include: properly assessing eligibility for the exemption subject to the specifics of different member states, analyzing its profitability in the context of losing eligibility to deduct VAT, preparing the required registration documents, support with quarterly reporting and monitoring of limits in different currencies, as well as assistance when SME and VAT OSS need to be applied simultaneously. It is also advisable to have professional support when making a decision to opt out of the exemption and when preparing a strategy for when the turnover limits are exceeded.



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