UNICE

The Voice of Business in Europe

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COMMISSION PROPOSAL, COM (2000) 349 FINAL, FOR A COUNCIL DIRECTIVE AMENDING DIRECTIVE 77/388/EEC AS REGARDS THE VALUE ADDED TAX ARRANGEMENTS APPLICABLE TO CERTAIN SERVICES SUPPLIED BY ELECTRONIC MEANS

UNICE COMMENTS

Summary

UNICE, as well as the Council, endorses the following principles for digital deliveries:

?? Electronic supplies shall be treated as services
?? Supplies consumed in the EU shall be taxed in the EU

We also endorse the OECD Ottawa conference principles of neutrality, effectiveness and simplicity.

UNICE has identified the following problems concerning business to consumer supplies digitally delivered:

1. There is a neutrality problem between EU and non-EU suppliers.
2. There is a neutrality problem with different rates within the EU for the same products.
3. There is a neutrality problem with different rates for similar products.
4. There will be enforcement problems with suppliers outside the EU.

Of the problems raised above, a majority of UNICE member federations takes the view that the most pressing is the first, the lack of neutrality between EU and non-EU operators. UNICE strongly supports the Commission aim to obtain a level playing field between EU and non-EU operators. The Commission proposal requires the urgent development of adequate and simple technical means to enforce taxation of non-EU on-line suppliers within the EU.

For a level playing field to be obtained it is important that EU and non-EU suppliers are treated in the same way in reality and not just in theory. UNICE is of the opinion that the risk that non-EU suppliers will not comply is significant.

A majority of UNICE member federations proposes the use by all Member States, of a uniform VAT rate for the digital deliveries contained in the Commission proposal. The level of such a rate should reflect the need to remedy the neutrality problem between EU and non-EU operators while also taking account of the neutrality problem between similar products.

In principle, UNICE is not in favour of an additional VAT rate, but in UNICE´s view the only way to deal with the neutrality problems mentioned above is a uniform rate.

UNICE proposes that this uniform rate could, if necessary, be established on a provisional basis until enforcement methods are decided upon by international bodies. What we cannot do is continue to accept a situation in which the playing field is not levelled, because this will inhibit the development of e-commerce within the EU.

Since this may be an interim solution, UNICE agrees with the Commission that it is not necessary to extend it to all kinds of digital deliveries.

Introduction and general remarks

On 7 June 2000 the European Commission presented a proposal for a directive amending the arrangements applicable to VAT [COM (2000) 349] on services supplied by electronic means, whose purpose is to modernise the existing rules in line with the principles adopted by the European Union and at the 1998 OECD Ottawa conference.

The Commission's objective is clear: to take account of the emergence of the Internet as a vector for international trade. To that end, it is necessary to reduce legal uncertainty, to promote a straightforward environment and to develop balanced competition by eradicating tax-related distortions.

The development of information and communications technology brings new and challenging opportunities for business and industry within the global market in the form of electronic commerce. In this field, two kinds of e-commerce can be distinguished; 1) off-line e-commerce (where ordering, invoicing and possibly payment is done by electronic means, but where goods or services are physically delivered, and 2) on-line e-commerce, where the services themselves (including 'virtual goods') are also supplied by electronic means. The present VAT rules were designed when e-commerce did not yet exist. The on-line form of e-commerce especially requires new VAT arrangements in order to avoid distortion of competition in a global economy with growing e-commerce. UNICE therefore welcomes the European Commission's recent initiative in this area.

Before going into detail on the various aspects of the Commission's proposal, we wish to make some general comments. UNICE believes that new VAT rules for on-line services should build upon the basic principles of VAT and the conclusions within OECD, as agreed in Turku (1997) and Ottawa (1998): taxation should take place in the jurisdiction where consumption takes place (the country of destination principle). It should also, as far as possible, adhere to the principles of neutrality, effectiveness and simplicity.

Digital deliveries create some new problems and shed light on some old ones, especially concerning supplies to non-taxable consumers:

1. There is a neutrality problem between EU and non-EU suppliers.
2. There is a neutrality problem with different rates within the EU for the same products.
3. There is a neutrality problem with different rates for similar products.
4. There will be enforcement problems with suppliers outside the EU

A majority of UNICE member federations consider the first problem, the lack of neutrality between EU and non-EU suppliers for supplies to consumers, to be the gravest. Already European companies are setting up subsidiaries in third countries in order to be able to sell without VAT and this movement is expected to grow. The Commission proposes a solution that would rectify this problem only to some extent.

As regards supplies of on-line services to non-taxable customers (B2C, or business to consumer), the Commission proposes to apply the country of origin principle within the EU, in combination with a single place of registration (SPR) for non-EU suppliers.

This pragmatic proposal is obviously made with the aim of achieving at least some degree of neutrality between EU operators and non-EU operators. At present there is a severe lack of neutrality between them, to the disadvantage of the EU operators. This lack of neutrality is

worse for EU businesses selling similar goods which are subject to the distance selling rules. In order to cure this lack of neutrality as soon as possible, the EU cannot wait for the parallel OECD process to come to a conclusion and make recommendations.

UNICE is aware of the difficulties for Member States to accept the SPR solution, but would like to emphasize that the alternative raises the risk of non-compliance from third-country operators. We need some incentive for the operator willing to comply.

With no additional provisions, however, the Commission proposal will still distort competition as long as the VAT rates for digital deliveries are not harmonised within the EU. UNICE recognises that, given the variety of normal VAT rates (15%-25%), the proposal will lead to a situation in which EU suppliers of on-line services may be induced to establish their business or create a fixed establishment in a Member State with the lowest rate, in order to supply to their non-taxable customers throughout the EU. This would also be the case for non-EU suppliers who would have to register for supplying on-line services to non-taxable customers in the EU.

There are two possible solutions to this problem.

1. <u>Harmonise the VAT rates for digital deliveries.</u>

The obvious disadvantage with this solution is the lack of neutrality between a product, e.g. software, delivered physically and the same software delivered digitally. In the view of a majority of UNICE's member federations, however, this distortion is smaller than the distortion we have at present with non-EU operators not being obliged to apply VAT. We already have and live with that particular distortion in several Member States, as books for example are often sold at a reduced VAT rate.

That proposed harmonised rate should be set at a rate which reflects the need to remedy the neutrality problem between EU and non-EU operators while also taking account of the neutrality problem between similar products. It would also minimise unfair competition from non-complying businesses outside the EU. However, special attention would have to be taken to monitor the risk of the distortion just mentioned.

2. <u>Extend taxation of digital deliveries to the place of consumption, also for supplies to private consumers (distance selling).</u>

This solution would make it possible to:

?? meet the objective of the proposal for a directive (tax within the EU supplies consumed in the EU)

?? harmonise the regime applicable to points 9-2 c and 9-2 e of the Sixth VAT directive

?? avoid use of the adjective "fixed" for the place where a foreign supplier is registered and hence reducing the risk of definitions for indirect taxation having an impact on rules for direct taxation.

However, to determine the place of the supplier or that of the buyer, the proposal refers to "the place where the customer has established his business or has a fixed establishment". Does a server or a domain name constitute a fixed establishment? This question still has to be answered.

In addition, the draft indicates that a supplier will be deemed to have a fixed establishment with regard to VAT in the country of registration. UNICE would like to point out that there is a difference between the concept of fixed establishment for direct taxes and that for indirect taxes.

A drawback of the second solution is that it would make it necessary for an EU trader to register in every Member State where he has customers, and hence it is not a viable solution since it would hamper the evolution of e-commerce. It would also be impractical for businesses to have to determine the correct country and VAT rate to be applied to sales on line. To avoid EU/non-EU distortions, non-EU businesses would also be required to register in all 15 Member States (a concern highlighted earlier).

A majority of UNICE member federations therefore is in favour of the first solution, a harmonised rate for on-line deliveries within the European Union.

Since the primary objective of the Commission proposal is to deal with the lack of neutrality between EU and non-EU operators, something UNICE endorses, UNICE proposes that that rate could be set at a level which takes into account the main problems described above. If the rate to be used is set at the standard rates UNICE fears that the likelihood of non-complying third country operators will be far too great for European operators. The loss of revenue for Member States could also be substantial if they cling to the normal standard rates, i.e. the loss of revenue from income taxation of both companies and employees.

However, such an arrangement may be needed only until international bodies adopt new enforcement and compliance rules, until the development process for e-commerce has gone further. UNICE therefore suggests that the special rate might be set initially for a limited period of time. The principle of a harmonised rate would however have to be kept.

For business-to-business (B2B) transactions UNICE strongly endorses the Commission proposal of the use of reverse charge.

Goods or services

Concerns have been expressed in some quarters about the potential implications for the classification of digitised products as goods or services under international trade rules. However, these concerns seem to be unfounded as the proposals only operate for EU VAT law purposes. EU VAT law only recognises two categories of supply: goods and services. As the OECD has established that digitised products are not goods, it follows – for EU VAT purposes only – that they are treated as services. This does not affect their customs classification, i.e. the issue of whether they are subject to the GATT or GATS rules.

Scope and definitions

The proposed amendments of the Sixth Directive focus on the place where supplies of certain services by electronic means are taxable for VAT.

The scope is set by three criteria:

a) In accordance with art. 6 of the Sixth Directive, supplies by electronic means are services, as they do not fall under the definition of goods in art. 5 of the Sixth Directive (re. explanation to art. 1(1) of the Amending Directive, page 12);

b) The definition of 'supplies by electronic means' is given in the proposed art. 9 (2) f of the Sixth Directive (re. art. 1 (1) of the Amending Directive) and reads '....a transmission sent initially and received at its destination by means of equipment for the processing (including digital compression) and storage of data, and entirely transmitted, conveyed and received by wire, by radio, by optical means or by other electronic means, including television broadcasting within the meaning of Directive EEC/89/552 and radio

broadcasting';

c) The services that fall under the new rule for the place of taxation are restricted to those mentioned in the proposed art. 9(2) f of the Sixth Directive (Re. art. 1(1) of the Amending Directive), i.e. the services mentioned in art. 9(2) c, first indent of the Sixth Directive ('cultural, artistic, sporting, scientific, educational, entertainment or similar activities, including the activities of the organisers of such activities, and where appropriate, the supply of ancillary services', which includes all forms of broadcasting and other sound and images released and delivered by electronic means), software, the supplying of information and data processing (as mentioned in art. 9(2) e, third indent of the Sixth Directive).

As regards a) above, UNICE would like to point out the increasing blurring between goods and services, as new combinations of off-line and on-line products will become available on the market. Both technically and commercially it will be possible to supply cell phones, television sets, lap tops, small and major domestic products and even cars separately off-line at low costs (or for nil), whereas the software required for the functioning of these hardware products (goods) is supplied (once or as subscription) as an on-line service by electronic means. UNICE is of the opinion that both the VAT aspects and the customs aspects of such 'split supplies' should be addressed in the framework of the present proposal.

As regards b) and c) above, the addition of Article 9(2)(f) to cover digital deliveries with different rules from Article 9(2)(e) could create both administrative complexity and distortion in favour of non-EU suppliers where 'bundled' or composite supplies with elements falling within the different sub-paragraphs are made.

Broadcasting has not been included as a specific item in Article 9(2)(f), which seems very odd considering the preamble. TV broadcasting supplies that fall within Article 9(2)(c) will be included in the new Article 9(2)(f). This seems to include certain aspects of broadcasting but not all. This area needs redrafting to identify clearly what is included in Article 9(2)(f). Digital deliveries and broadcast services should be subject to the same rules.

Clearer definitions are needed of data processing and computer services to prevent significant differences of interpretation.

The place of supply of services by electronic means

In the proposed art. 9(2)(f), after the first indent, the word 'customers' is used, whereas after the second and third indent the word 'persons' has been used. This may lead to confusion. As the word 'customer', after the first indent, should be understood as 'taxable and non-taxable persons', UNICE would suggest replacing the word 'customer' by 'persons'.

According to the proposed art. 9(2)(f), the on-line supply of services to a taxable person in (another Member State of) the EU is taxable where the latter is established. Therefore the supplier should verify the VAT identification number of that customer. In the new sub-paragraph to art. 21(1) a, it is said that the supplier should act in this respect 'with all possible diligence normally used in commercial practice of a given sector'. UNICE is of the opinion that clear safe harbour rules should be given in order to avoid diverging interpretation of this provision by the individual Member States. Otherwise this is potentially a very onerous requirement. Whilst tax authorities will want to ensure that the supplier has taken reasonable steps to comply, the burden must be kept light. This can only be achieved if both tax authorities and businesses are clear on what is required, if the requirements are

practical in a business context, and that, provided those requirements have been fulfilled, the supplier will not be assessed in respect of errors made in good faith.

According to the Commission's proposals, cross-border supplies of on-line services to non-taxable customers are subject to VAT in the country of origin, i.e. the country of the supplier. The first paragraph after the third indent of the new art, 9(2) f should be understood as follows: for an on-line service when it is supplied by a taxable person in a Member State to a non-taxable person established in another Member State, the place of supply shall be the place where the supplier has established his business or has a fixed establishment from which the service is supplied.

As regards the supplies of on-line services for an annual turnover of at least €100,000 by a non-EU supplier to non-taxable customers in the EU, the proposal is not clear. Does this threshold relate to digital deliveries only, or to all supplies in the EU? In its explanatory memorandum to the proposals (page 7) the Commission states that a single registration by such suppliers is 'envisaged'. In the summary on page 16 of the explanatory memorandum it is said that 'a single place of registration (which will in practice normally be the Member State to where a first taxable supply is made) will be possible'. On the other hand, the new provision (f) in art. 22(1) of the Sixth Directive (introduced by art. 1(5)(b) of the Amending Directive) reads that a non-EU supplier of on-line services shall be required to identify for VAT purposes 'in a Member State into which he supplies services'. UNICE finds this wording not clear, as it could be understood either as 'in each Member State into which he supplies services' or as 'in one of the Member States in which he supplies services'.

Furthermore, it is not clear why the Commission proposes the additional provision in art. 22(1)(f) that the Commission will review and possibly propose changes of this particular measure no later than the end of 2003. Anyhow, if there is to be single registration for non-EU suppliers of on-line services, this will inevitably lead in many cases to choosing the Member State with the lowest VAT rate.

Clarification is also required on the interaction with the rules on sales of goods and distance selling.

The EU supplier of on-line services

The proposal is based upon the crucial assumption that the supplier can identify both the VAT status and the country of the customer receiving on-line services. If the customer is a taxable person in another Member State, he will submit his VAT identification number to the supplier (to be verified through the VIES) and the reverse charge system will make it possible for him to deduct the VAT due in his own Member State. However, a problem may arise if there are no reliable technical means to identify the country of a non-taxable customer. In that case, the question whether the customer is established in the Member State of the supplier or in another Member State or outside the EU cannot be answered. Consequently the supplier must act as if the customer is established in the same Member State and charge the VAT of that Member State.

If the country of establishment of a non-taxable customer in a third country cannot be identified, this will lead to the consumption of on-line services outside the EU bearing VAT of the EU country of the supplier. In its explanatory memorandum (page 8) the European Commission states that 'the standard commercial practice of requesting a verifiable credit card billing address may offer the best option at the moment'.

Yet it is questionable whether the various and sometimes hidden indicators applied by credit card organisations will indeed provide a workable option for the suppliers who have to keep a controllable set of data for VAT purposes. The Commission seems to share this concern as it states that it will 'continue to work, notably within the OECD, on identifying suitable and accessible manners for determining the place of supply' of on-line services (read: the place where the customer is established).

The Commission expresses its optimism as regards the possibilities of introducing a country indicator within the address data of the customer (which would indeed be sufficient for the purpose) and refers to the credit cards where a country indicator is applied without disclosing the identity of the payer. However, as long as no suitable and workable means have been found and internationally implemented to identify the country of the consumer of on-line services, either through the address data or through the payment trail, on-line services supplied by a supplier in that Member State to consumers in third countries may bear EU VAT and therefore be in a disadvantageous position on the global market.

Therefore, and also because many transactions are likely to be conducted on screen in real time, it should be possible for the customer to give an on-line declaration of status and for the supplier to rely on that. The supplier should not be required separately to verify the details to confirm zero-rating – by then the potential customer will have gone elsewhere or lost interest in the purchase.

If, as is proposed, the country reference digits on a debit or credit card are to be used to determine the residence of a customer, a supplier should be able to rely on this information where obtained and acted on in good faith without fear of subsequent assessment if it turns out to be incorrect. One possible additional safeguard would be to require the customer's address in addition to credit/debit card details. The practical limitations of such a scheme should be discussed and agreed with business before implementation.

Whilst the use of credit or debit card details may work in the short term, in the longer term the use of e-cash and other payment methods may undermine this. Consideration should be given to the use of digital certificates as potentially being more reliable. Any legislation should, therefore, be flexible enough to enable new methods of determining VAT registration and liability to be considered and adopted if practical.

The non-EU supplier of on-line services

A non-EU supplier of on-line services should be able to detect whether customers are established in a Member State of the EU and whether his annual turnover of on-line services to customers in the EU exceeds € 100,000.

Again, the existence of reliable technical means for identifying the place of establishment of the customer is crucial. If the non-EU supplier cannot detect the EU jurisdiction of his customer, he must assume that the customer is not established in the EU. Depending upon the legislation in his own country, the non-EU supplier may or may not charge VAT, Turnover Tax or Sales Tax to the customer.

If reliable means for identification become available, the non-EU supplier should also record the turnover of on-line sales to all customers in the various EU Member States , in order to establish whether his annual turnover in the EU exceeds € 100,000. He should be able to choose to register for VAT purposes in one of the Member States to which he has made supplies, and he will be deemed to have a fixed establishment in that Member State for the purposes of Article 9 (2) f.

The proposed system requires that the tax administrations of the EU Member States must (in close co-operation) be able to detect a non-EU supplier and to get access to his records in order to control his turnover in relation to on-line services supplied to non-taxable persons, wherever in the EU. UNICE has the impression that the Commission's proposal focuses on suppliers of on-line services with high standards for business practice, as the Commission seems to believe that operators, even outside the EU, do not want to risk exposure to significant and unresolved tax debts in the EU. If the Commission's assumption would appear to be too optimistic, distortion of competition may arise for compliant EU and non-EU taxpayers involved in on-line e-commerce.

Moreover, it cannot be excluded that a non-EU supplier who wants to avoid his supplies of on-line services being subject to VAT in the EU and thus avoid any VAT compliance within the EU, would legitimately be able to establish a series of legal entities in his own country (or elsewhere outside the EU) if his turnover to non-taxable EU customers will soon exceed the threshold of € 100,000.

The proposed € 100,000 registration limit for non-EU suppliers is substantially higher than the registration thresholds in most Member States, which means that the existing competitive disadvantage would remain for many EU businesses. The limit also leaves scope for manipulation similar to that which currently occurs in distance selling. Both these problems would be reduced with a harmonised rate at a level that reflects the need to remedy the neutrality problem between EU and non-EU operators while also taking account of the neutrality problem between similar products.

VAT compliance by electronic means

According to the proposed amendments to art. 22(1) a, art. 22(4) a and art. 22(6) a of the Sixth Directive, Member States shall (subject to conditions which they lay down) allow the use of electronic means by taxable persons when they fulfil VAT compliance. This refers to the obligation for a taxable person to state when his activity as such commences, changes or ceases, the submission by a taxable person of a periodical VAT return and the submission by a taxable person of a statement (if a Member State so requires) including all particulars concerning all transactions carried out in the preceding year.

UNICE welcomes the proposal to permit complying by electronic means. However, there should be a time limit for implementation by Member States. As these provisions have a general scope and do not exclusively apply to the supply of on-line services, they will contribute to easier and less costly administrative procedures for business and industry within the internal market of the EU and those outside the EU doing business with customers in the EU.

As regards the verification of the VAT status of a customer, in particular the VAT identification number of a taxable person through the VIES, UNICE would like to stress that both the request for verification and the certificate of verification can be submitted and received by electronic means.

The proposals do not cover the detailed administrative implications, although we welcome the commitment to removing restrictions on the use of paperless recording of transactions. It is essential that compliance burdens are kept to a minimum and that onerous new conditions are not introduced. Common rules on electronic invoicing (including credit notes and self-billed invoices), electronic signatures and electronic verification of VAT numbers are needed as soon as possible. Businesses should be able to retain electronic records in a single jurisdiction – not be required to keep them in every jurisdiction in which electronic commerce is conducted – provided tax auditors from the other jurisdictions can have access to them.

Enforcement

There is widespread concern that adequate means of enforcing compliance by non-EU suppliers of digitised products to EU consumers have not yet been developed. However, it is expected that all major suppliers will comply, and therefore the reduction in the level of unfair competition will be of real benefit to EU businesses.

Intergovernmental co-operation is needed to achieve compliance by all business sectors. Laying the compliance burden on EU businesses, for example by requiring telecom

suppliers to enforce VAT registration by cutting off telecommunications or getting credit card companies to impose tax without adequate safeguards for business, should not be considered because there are wider legal and commercial implications.

In paragraph 3.3 on page 10 it is stated, “normal accepted standards of statutory auditing or due diligence examinations would be expected to detect failure to comply with tax obligations”. This would only be true in the case of values that are ‘material’ in audit terms. Therefore VAT liabilities could arise that are significant in local tax authorities’ eyes but are below the auditor’s materiality level.

Implementation date

Art. 2 of the Amending Directive states that the Member States shall implement the changes of the Sixth Directive in their national legislation by 1st January 2001. Although UNICE is aware of the need for urgency to take adequate measures for levying VAT in a global e-commerce environment, it hopes that the above initial comments and further, more detailed observations that may come up in the dialogue between business and industry and the public organisations involved, will be taken into account in the decision process of the Council. Lack of clarity and neutrality in the effects of these measures will give rise to distortion of competition and should therefore be avoided.

Conclusion

The proposal represents a significant and generally well-founded attempt to tackle a potentially problematic area of tax collection and address an area where EU businesses are operating at a competitive disadvantage. There are some areas of concern with enforcement issues, the details of implementation and, in some instances, the lack of detail. In particular, the use of a new Article 9.2(f) is questioned in respect of its basis for taxation compared with Article 9.2(e). This will lead to distortions, with adverse consequences for businesses in terms of competitiveness and compliance burdens. It is important that practical solutions are found as soon as possible to ensure successful implementation of the directive. However, combined with the new approach of a harmonised VAT rate for digital deliveries UNICE believes that these proposals should be supported as they represent a major step towards achieving a level playing field in e-commerce.