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# **VAT and E-services**

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# Summary

The emergence of electronic commerce in the 1990's was acknowledged by both the OECD and the EU to bring about prospects of great profits for businesses as well as huge challenges for fiscal authorities. By its very nature, electronic commerce is global, instantaneous, without traditional borders and conducted with relative anonymity. These aspects make it difficult for a traditional tax system to cope with.

Under the Sixth VAT Directive, the EU taxed electronic services at the origin. This had the effect that non-EU suppliers of electronic services were not subject to VAT for their supplies to EU customers while EU e-suppliers were subject VAT, both for intra-community and outbound supplies, creating a competitive disadvantage for them.

In order to adjust that distortion and other challenges that electronic commerce brought about, the EU introduced special rules in respect of electronic services into the VAT Directive in the early 2000's. Accordingly, most electronic supplies, including those supplied by non-EU e-suppliers, would be taxed at destination. To ease the compliance burden for these e-suppliers, a single registration scheme was introduced, letting them register in one "Member State of identification" instead of having to register in each Member State where they had customers. Nevertheless, the e-supplier carried a significant compliance burden as they were obliged to locate and identify their customers, something that has proved to be difficult in a digital context. Moreover, the taxation of electronic supplies also suffers from enforcement issues. These issues are likely to worsen in the near future since all electronic services will be taxed at destination as of 1 January 2015. Even though the EU has adopted complex Implementing Regulations in order to, with greater stringency, locate and identify purchasers of electronic services, it is doubtful whether these efforts will have any effects. Paradoxically, a technological solution in respect of the collection mechanism may be the best way to deal with these technology induced issues.

# Sammanfattning

Framväxten av elektronisk handel under 1990-talet ansågs av både OECD och EU skapa såväl förutsättningar för stora vinster för företag som stora utmaningar för skattemyndigheterna. Till sin natur är elektronisk handeln global, omedelbar, utan traditionella gränser och genomförs med relativ anonymitet. Dessa aspekter innebär svårigheter för ett traditionellt skattesystem.

Enligt sjätte mervärdesskattedirektivet beskattades elektroniska tjänster enligt ursprungslandsprincipen. Detta fick till följd att leverantörer av elektroniska tjänster som inte var etablerade i EU inte omfattades av mervärdesskatt för sina leveranser till kunder inom EU. Samtidigt var leverantörer av elektroniska tjänster som var etablerade inom EU föremål för mervärdesskatt för omsättningar både inom EU och utanför EU vilket skapade en konkurrensnackdel för dem i förhållande till utomeuropeiska leverantörer.

För att hantera denna och andra problem som den elektroniska handeln medförde så införde EU särskilda regler för elektroniska tjänster i mervärdesskattedirektivet i början av 2000-talet. I enlighet med dessa så skulle de flesta elektroniska omsättningar, inklusive de som genomfördes av leverantörer etablerade utanför EU, beskattas på destinationsorten. För att underlätta för dessa leverantörer att efterleva sina skatteförpliktelser så infördes en särskild ordning med en kontaktpunkt. Enligt denna särskilda ordning så kan en icke-etablerad leverantör välja att registrera sig för mervärdesskatt i en "identifieringsmedlemsstat" i stället för att behöva registrera sig i varje medlemsstat där denne har kunder. Trots detta så bär leverantörerna en betydande börda i att de är tvungna att lokalisera och identifiera sina kunder, något som har visat sig vara svårt i en digital kontext. Vidare så lider systemet av genomdrivandesvårigheter. Dessa problem kommer sannolikt att förvärras inom den närmaste framtiden eftersom alla elektroniska tjänster ska beskattas på destinationsorten från och med den 1 januari 2015. Även om EU har antagit komplexa tillämpningsföreskrifter för att med större säkerhet kunna lokalisera och identifiera köpare av elektroniska tjänster är det osäkert vilken effekt dessa insatser kommer att ha. Paradoxalt nog kan en

teknisk lösning beträffande skatteinsamlingen vara det bästa sättet att lösa dessa ur teknik sprungna problem.

# Abbreviations

B2B	Business to Business
B2C	Business to Consumer
CFA	Committee on Fiscal Affairs, an organ of the OECD
Commission, the	The European Commission
ECJ, the	The EU Court of Justice
EU, the	The European Union
E-supplier	A supplier of electronic services
OECD, the	The Organisation for Economic Co-operation and Development
RVD, the	The Recast VAT Directive, Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

# 1 Introduction

## 1.1 Background

The development of electronic commerce introduced new opportunities for businesses but also new fiscal challenges. By its very nature, electronic commerce is global, instantaneous, without traditional borders and conducted with relative anonymity. These aspects make it difficult for a traditional tax system to cope with.

The EU acknowledged both the potential and the challenges it would entail and moved from a system that taxed electronic services at origin to a system that more and more taxes these services at destination. However, taxing electronic services at destination rests on the simplistic assumption that it will be able to identify the status and the location of a customer in a digital context. Hence it is questionable if taxing electronic services at destination is effective and other alternatives should, perhaps, be investigated.

## 1.2 Purpose

The purpose of this thesis is to investigate how electronic services and electronically supplied services are treated for VAT purposes in the EU. In particular I will attempt to answer the questions “What are electronically supplied services?”, “Why are they difficult to tax?” and “How does the EU tax, and how will the EU tax, electronically supplied services?”. I will also assess the EU VAT rules on electronic services and discuss alternative methods to tax these services.

## 1.3 Method and Material

The method being used in this thesis is legal dogmatic method, making use of written law, case law, preparatory work, supplement work, guidelines and doctrine as sources. This thesis relies heavily on written law, preparatory and supplement work and doctrine. These sources are used to identify what electronic services are, where the difficulty of their taxation lies and to describe



and discuss past, present and future provisions on the issue. Doctrine will also be relied upon as inspiration for the discussion about alternative methods to tax electronic services. As the prevalence of case law on this topic is meagre, to say the least, it will not occur in the thesis to any larger extent. Rather it will be mentioned incidentally, mostly to illustrate a particular point.

## **1.4 Delimitations**

The focus on this thesis is on the EU legislation. To some extent material from the OECD will be discussed. National law will not be taken into account.

Moreover, the reader is presupposed to have some previous knowledge of the EU VAT system as the paper will not provide any description of the VAT Directive as such.

# 2 What are electronic services and electronically supplied services?

## 2.1 General Definition

What are electronic services? The Oxford Dictionary define e-commerce as commercial transactions conducted electronically on the internet.<sup>1</sup>

As Bevers observes, in literature there is a whole range of definitions to the term.<sup>2</sup> In doctrine, Eriksen and Hulsebos, for instance, have defined e-commerce as a way to facilitate the exchange of goods, services, and information, via a standards-based electronic medium, by both consumers and corporations. Conceptually, it is an electronic flow designed to facilitate a more efficient stream of information, products, and funds through multiple organisations' business processes.<sup>3</sup>

Broadly speaking, two forms of e-commerce to be distinguished according to the mode of delivery of the product or service – direct and indirect electronic commerce. Indirect e-commerce is the electronic ordering of tangible goods, which must be physically delivered using traditional channels such as postal services or commercial couriers. Direct e-commerce is the online ordering, payment and delivery of intangible goods and services such as computer software, entertainment content or information services on a global scale.<sup>4</sup>

## 2.2 The VAT Directive<sup>5</sup>

Both Article 58 and 59(k)RVD refers to Annex II of the RVD for a definition of electronic services and electronically supplied services. As mentioned above, it

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1 Oxford Dictionary, <http://www.oxforddictionaries.com/definition/english/e-commerce?q=e-commerce> accessed 2013-12-13.

2 Bevers G., *Value Added Tax and Electronic Commerce*, British Tax Review 2001.

3 Eriksen N., Hulsebos K., *Electronic Commerce and VAT – An Odyssey towards 2001*. VAT Monitor July/August 2000.

4 Bevers G., *Value Added Tax and Electronic Commerce*, British Tax Review 2001 and Communication “*A European Initiative in Electronic Commerce*”, (Green Paper) COM (97) 157, April 15, 1997.

5 The Recast VAT Directive, Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax

must be noted that where the supplier and the customer have merely communicated by e-mail, that does not constitute an electronic supply.<sup>6</sup>

Annex II is indicative and mentions the following services as being electronic or electronically supplied:

- (1) Website supply, web-hosting, distance maintenance of programmes and equipment;
- (2) supply of software and updating thereof;
- (3) supply of images, text and information and making available of data-bases;
- (4) supply of music, films and games, including games of chance and gambling games, and of political, cultural, artistic, sporting, scientific and entertainment broadcasts and event;
- (5) supply of distance teaching.<sup>7</sup>

## 2.3 VAT Guidelines

In its 2003 guidelines, the VAT Committee explored the concept further. However, it should be noted that it is stated explicitly that the guidelines are not exhaustive.<sup>8</sup>

An “electronically supplied service” is described as on that (1) in the first instance is delivered over the internet or an electronic network and (2) then the nature of the nature of the service in question is heavily dependent on information technology for its supply (i.e., the service is essentially automated, involving minimal human intervention and in the absence of information technology does not have viability).<sup>9</sup>

On the basis of the above two-step test, the committee stated that “electronically supplied services” included:

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<sup>6</sup> Article 58 and 59(k) RVD

<sup>7</sup> Annex II of the RVD.

<sup>8</sup> GUIDELINES RESULTING FROM THE 67TH MEETING of 8 January 2003

DOCUMENT A – TAXUD/2303/03 -”Electronically Supplied Services” Guide to Interpretation

<sup>9</sup> GUIDELINES RESULTING FROM THE 67TH MEETING of 8 January 2003

DOCUMENT A – TAXUD/2303/03 -”Electronically Supplied Services” Guide to Interpretation

- *digitised products* generally, such as software and changes to or up-grades of software; or
- *a service* which provides, or supports a business or personal presence on an electronic network (e.g. , web site or web page); or
- *a service automatically generated from a computer*, via the internet or an electronic network, in response to specific data input by the customer; or
- *services, other than those specifically mentioned in Annex II, which are automated and dependent on the internet or an electronic network for their provision.*<sup>10</sup>

Telecommunication services and radio and television broadcasting services, however, should not be regarded as electronically supplied services.<sup>11</sup>

Furthermore, the guidelines state that electronically supplied services will be taxable at the standard rate by a Member State, unless an exempting provision in a Member State applies. If a supply is not considered to constitute an electronically supplied service it should be treated in accordance with other place of supply rules. In case of composite transactions, these transactions must generally be assessed on a case-by-case basis.<sup>12</sup>

It should be noticed that the guidelines do not bind the EU and the Member States are free to apply them.<sup>13</sup> They could be considered to be “soft law”.<sup>14</sup>

## **2.4 Implementing Regulation 282/2011<sup>15</sup>**

In addition the above said, Article 7 of Implementing Regulation 282/2011 states that electronic services shall include services which are delivered over the internet or an electronic network and the nature of which renders their supply

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10 GUIDELINES RESULTING FROM THE 67TH MEETING of 8 January 2003

DOCUMENT A – TAXUD/2303/03 -”Electronically Supplied Services” Guide to Interpretation

11 GUIDELINES RESULTING FROM THE 67TH MEETING of 8 January 2003

DOCUMENT A – TAXUD/2303/03 -”Electronically Supplied Services” Guide to Interpretation

12 GUIDELINES RESULTING FROM THE 67TH MEETING of 8 January 2003

DOCUMENT A – TAXUD/2303/03 -”Electronically Supplied Services” Guide to Interpretation

13 GUIDELINES RESULTING FROM THE 67TH MEETING of 8 January 2003

DOCUMENT A – TAXUD/2303/03 -”Electronically Supplied Services” Guide to Interpretation

14 Bill, S., Kerrigan, A., *Practical Application of European Value Added Tax to E-commerce*. 38 Georgia Law Review 71 2003-2004

15 COUNCIL IMPLEMENTING REGULATION (EU) No. 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax

essentially automated and involving human intervention, and impossible to ensure in the absence of information technology. That includes, in particular;

(a) the supply of digitised products generally, including software and changes to or upgrades of software;

(b) services providing or supporting a business or personal presence on an electronic network such as a website or a webpage;

(c) services automatically generated from a computer via the Internet or an electronic network, in response to specific data input by the recipient;

(d) the transfer for consideration of the right to put goods or services up for sale on an Internet site operating as an online market on which potential buyers make their bids by an automated procedure and on which the parties are notified of a sale by electronic mail automatically generated from a computer;

(e) Internet Service Packages (ISP) of information in which the telecommunications component forms an ancillary and subordinate part (i.e. packages going beyond mere Internet access and including other elements such as content pages giving access to news, weather or travel reports; playgrounds; website hosting; access to online debates etc.);

(f) the services listed in Annex I.

Annex I of the Implementing Regulation refers to the Annex II of the VAT Directive and is very much a clarification of the services mentioned there. It lists the following services:

(1) Point (1) of Annex II to Directive 2006/112/EC:

(a) Website hosting and webpage hosting;

(b) automated, online and distance maintenance of programmes;

(c) remote systems administration;

(d) online data warehousing where specific data is stored and retrieved electronically;

(e) online supply of on-demand disc space.

(2) Point (2) of Annex II to Directive 2006/112/EC:

- (a) Accessing or downloading software (including procurement/accountancy programmes and anti-virus software) plus updates;
- (b) software to block banner adverts showing, otherwise known as Bannerblockers;
- (c) download drivers, such as software that interfaces computers with peripheral equipment (such as printers);
- (d) online automated installation of filters on websites;
- (e) online automated installation of firewalls.

(3) Point (3) of Annex II to Directive 2006/112/EC:

- (a) Accessing or downloading desktop themes;
- (b) accessing or downloading photographic or pictorial images or screensavers;
- (c) the digitised content of books and other electronic publications;
- (d) subscription to online newspapers and journals;
- (e) weblogs and website statistics;
- (f) online news, traffic information and weather reports;
- (g) online information generated automatically by software from specific data input by the customer, such as legal and financial data, (in particular such data as continually updated stock market data, in real time);
- (h) the provision of advertising space including banner ads on a website/web page;
- (i) use of search engines and Internet directories.

(4) Point (4) of Annex II to Directive 2006/112/EC:

- (a) Accessing or downloading of music on to computers and mobile phones; (b) accessing or downloading of jingles, excerpts, ringtones, or other sounds;
- (c) accessing or downloading of films;
- (d) downloading of games on to computers and mobile phones;

(e) accessing automated online games which are dependent on the Internet, or other similar electronic networks, where players are geographically remote from one another.

Point (5) of Annex II to Directive 2006/112/EC:

(a) Automated distance teaching dependent on the Internet or similar electronic network to function and the supply of which requires limited or no human intervention, including virtual classrooms, except where the Internet or similar electronic network is used as a tool simply for communication between the teacher and student;

(b) workbooks completed by pupils online and marked automatically, without human intervention

However, Article 7 of the Implementing Regulation States explicitly that the following services do not constitute electronic services:

(a) radio and television broadcasting services;

(b) telecommunications services;

(c) goods, where the order and processing is done electronically;

(d) CD-ROMs, floppy disks and similar tangible media;

(e) printed matter, such as books, newsletters, newspapers or journals;

(f) CDs and audio cassettes;

(g) video cassettes and DVDs;

(h) games on a CD-ROM;

(i) services of professionals such as lawyers and financial consultants, who advise clients by e-mail;

(j) teaching services, where the course content is delivered by a teacher over the Internet or an electronic network (namely via a remote link);

(k) offline physical repair services of computer equipment;

(l) offline data warehousing services;

- (m) advertising services, in particular as in newspapers, on posters and on television;
- (n) telephone helpdesk services;
- (o) teaching services purely involving correspondence courses, such as postal courses;
- (p) conventional auctioneers' services reliant on direct human intervention, irrespective of how bids are made;
- (q) telephone services with a video component, otherwise known as videophone services;
- (r) access to the Internet and World Wide Web;
- (s) telephone services provided through the Internet.

The first two Items, telecommunications and radio and broadcastings, are subject to separate rules governing their VAT treatment. The EU VAT system then differs between telecommunication services and radio and television broadcastings on the one hand and electronically supplied services on the other. Item (c) – (h) are tangible property or goods of some sort and thereby cannot be treated as services according to the present definition of goods and services. Item (i) – (p) are traditionally more dependent on human intervention than on a minimum scale and thereby fall outside the general description of electronically supplied services. Item (q) – (s) are covered by the definition of telecommunication services if telephone services are dependent on distance communication means covered by the definition of telecommunication services. Videophone services are likely to compete more with traditional telecommunication services and from a neutrality perspective these could be exchangeable and therefore should be covered by the definition for telecommunication services. Neutrality is then related functional equivalency between exchangeable supplies which may exist at both an internal, intra-external and external level.<sup>16</sup>

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<sup>16</sup> Rendahl, P. *Cross-border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-commerce*. 2008 Jönköping International Business School. Page 183



## 2.5 Implementing Regulation 1042/2013<sup>17</sup>

The list in the previous section very much corresponds to the services listed in its predecessor, Implementing Regulation 1777/2005.<sup>18</sup> However, Implementing Regulation 282/2011 has already been amended by Implementing Regulation 1042/2013 which has added a few new points. Accordingly, from 1 January 2015 four new subparagraphs, (f-i), to point 4 of Annex 1 are introduced. Subparagraph f and g deal with broadcastings over the internet or other communication networks that do not occur at the same time as a radio or television broadcasting and, hence, cannot be said to constitute radio or television broadcastings. This holds true even if the broadcasting is supplied by a supplier of media services under his editorial obligations.<sup>19</sup>

Subparagraphs h-i concern broadcastings over the internet or other networks that are not supplied under the editorial responsibility of a supplier of media services. Consequently, a broadcasting that does not fall under any editorial responsibility of a media supplier does not constitute a radio or television broadcasting even if it would be supplied at the same time as a broadcasting via a radio or television net.<sup>20</sup>

Implementing Regulation 1042/2013 will also bring some changes to Article 7, point 3. Subparagraphs q-s will be abolished. These subparagraphs deal with video telephony, access to internet and telephony through the internet. These services will be considered to constitute telecommunication services instead. Instead subparagraphs t and u are introduced to Article 7, paragraph 3. They are meant to clarify that the booking of, for instance, concert tickets, hotel rooms, car rental etc. over the internet do not constitute electronic services. The mere fact that booking is made over the internet does not mean that it is an electronic service.<sup>21</sup>

However, the above said does not preclude that companies that supply, to non-taxable persons, the service of automatised intermediation of hotel rooms on a

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17 COUNCIL IMPLEMENTING REGULATION (EU) No 1042/2013 of 7 October 2013 amending Implementing Regulation (EU) No 282/2011 as regards the place of supply of services.

18 COUNCIL IMPLEMENTING REGULATION (EU) No 1777/2005 laying down implementing measures for Directive 77/388/ECC on the common system of value added tax

19 Implementing Regulation 1042/2013

20 Implementing Regulation 1042/2013

21 Implementing Regulation 1042/2013 and Promenoria *Nya mervärdesskatteregler om omsättningsland för telekommunikationstjänster, radio- och tvsändningar och elektroniska tjänster*, Dnr Fi2013. Page 53.

webpage may be considered to supply electronic services. The service that is supplied, and which the customer pays a consideration for, is the automatised intermediation.<sup>22</sup>

In respect of gambling and lottery, it should be observed that such services may be exempted by the Member States. The rules on electronic service do not meddle with the ambit of the exemptions from VAT.<sup>23</sup>

As regards the supply of distance teaching, it should be pointed out that what is meant is an automatised and with limited, or without, human intervention. Hence, it does not include the correspondence by a human teacher through e-mail. Neither does the teaching where a human teacher and his pupils are attend a virtual classroom constitute an electronic supply. It should be noticed that also teaching services may be exempt from VAT.<sup>24</sup>

## 2.6 Remarks

As pointed out above, electronic services, generally speaking, can have a very wide definition. Broadly speaking, there are two main categories of electronic commerce – the indirect electronic ordering of tangible goods, which must be physically delivered using traditional channels such as postal services or commercial couriers and direct online ordering, payment and delivery of intangible goods and services such as computer software, entertainment content or information services on a global scale. For EU VAT purposes it is the latter category that is defined as electronic services or electronically supplied services and subject to special treatment.

The main principles concerning what is to be considered to be an electronic service for VAT purpose is sketched out in Annex II of the VAT Directive. Even though the list of electronic services provided in Annex II is intended to be indicative it seems as the list has been more and more specified by the consecutive Implementing Regulations in respect of what services are to be included or not included under the definition of an electronic service. However, it must be observed that the lists of services in the Implementing Regulations are not

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22 Promenoria *Nya mervärdesskatteregler om omsättningsland för telekommunikationstjänster, radio- och tvsändningar och elektroniska tjänster*, Dnr Fi2013. Page 53.

23 Promenoria *Nya mervärdesskatteregler om omsättningsland för telekommunikationstjänster, radio- och tvsändningar och elektroniska tjänster*, Dnr Fi2013. Page 53.

24 Promenoria *Nya mervärdesskatteregler om omsättningsland för telekommunikationstjänster, radio- och tvsändningar och elektroniska tjänster*, Dnr Fi2013. Page 54.

exhaustive. As Van der Merwe remarks, by keeping the lists non-exhaustive the EU avoid them from being obsolete.<sup>25</sup> I think that this is wise. Even though the EU legislator obviously made huge effort in listing and specifying as many electronic services as imaginable, it cannot foresee future turn of events and technological developments. Therefore, if the list was exhaustive, certain future electronic services could, potentially, slip outside the scope of VAT.

Rendahl and Parelli point out that the criterion that, at least generally, renders an electronically supplied service is the fact that it is automatically generated, without human control and interference.<sup>26</sup> Parilli criticises this since it is cumbersome to separate electronically supplied services from other services that involve the use of the internet and of computer equipment but that are not purely automated. In addition to that, he remarks that, in case of supply of distance teaching, it is pretty irrational to have to different regimes for long-distance live classes and purely virtual classrooms with no human intervention.<sup>27</sup> In that connection it should be noted that the ECJ has pointed out that “the characterisation of a good or service should not depend on the mode of distribution”.<sup>28</sup> In respect of that, it could also be argued that by deeming all electronic supplies to constitute services, the VAT Directive does not uphold that principle.

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25 Van der Merwe, B.A. 2004, *VAT in the European Union and Electronically Supplied Services to Final Consumers*, in South African Mercantile Law Journal, no. 16, p. 580

26 Rendahl, P. *Cross-border Consumption Taxation of Digital Supplies – A Comparative Study of Double Taxation and Unintentional Non-Taxation of B2C E-commerce*. 2008 Jönköping International Business School. Page 180 and Parilli, D. M., *European VAT and Electronically Supplied Services* Page 7

27 Parilli, D. M., *European VAT and Electronically Supplied Services* Page 7

28 See C-2/95 *Datacenter*

### 3 Difficulties to tax e-commerce

Both the EU and the OECD realised early on that the emergence of would bring about both business opportunities and fiscal challenges. In connection with the 1997 Turku Conference, the Committee for Fiscal Affairs (CFA) identified two types of business opportunities that electronic commerce created that would influence tax systems:

- i. New ways for businesses to advertise, sell and deliver products and services to customer,
- ii. New ways for businesses to communicate and organise their activities.

These new possibilities would be particularly for small and medium sized enterprises which would find it much easier to engage in international commerce.<sup>29</sup>

The CFA identified several aspects that would have particular impact on the operation of tax systems:

- i. Lack of any user control as to the location of activity

The nature of the system is such that it has no physical location. Users of the Internet have no control and in general no idea of the path travelled by the information they seek or publish. Many participants in the system are administrators or go-betweens who have no control over what type of information travels over their computer. In practice, it makes no difference whether the data or digital tokens sought to be transmitted are within one jurisdiction or between several, as the Internet pays little or no regard to national boundaries. As the physical location of an activity, whether in terms of the supplier, service provider or buyer of the goods or user of the service, becomes less important, it becomes more difficult to determine where an activity is carried out.

- ii. No means of identification of users

In general, proof of identity requirements for Internet use are very weak. The pieces of an Internet address (or “domain-name”) only indicate who is responsible for maintaining that name. It has no relationship to the

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<sup>29</sup> OECD (1997) – *Electronic Commerce: The Challenges to Tax Authorities and Taxpayers* page 5-6.

computer or user corresponding to that address or even where the machine is located. In addition, it is not difficult to introduce a new computer to the Internet which has the ability to be recognised anywhere else on the Internet. Registration requirements are not difficult to satisfy and there is little to prevent transfer of the site to new controllers.

iii. Reduced use of information reporting and withholding institutions.

In general, tax compliance is facilitated by identifying key “taxing points”: for example, reporting and withholding requirements can be imposed on financial institutions which are easy to identify. In contrast, one of the great commercial advantages of electronic commerce is that it often eliminates the need for intermediating institutions. Although from a purely economic perspective such “friction-free” capitalism may be an advantage of the new technologies, the potential loss of these intermediating functions poses a problem for tax administration.<sup>30</sup>

Similarly to the OECD, the EU acknowledged that fact that e-commerce is transnational to its nature created both opportunities and challenges. A risk to the revenues from network commerce lies in businesses and private individuals exploiting any uncertainty in the VAT regime to achieve savings in tax payment. Furthermore, the EU acknowledged the difficulty to localise and identify the parties to a transaction and problems in availability and access to information which may arise when records are kept in other jurisdictions or where the manner in the e-commerce functions lead to a degradation in audit trails as main issues.<sup>31</sup>

The emergence of electronic commerce has resulted in a sudden growth of B2C transactions. Traditional VAT systems are designed under the assumption that B2C supplies of services primarily takes place within national boundaries.<sup>32</sup> In case there would be a cross-border supply it would traditionally take place between neighbouring jurisdictions with similar tax features.<sup>33</sup> Due to the spreading of internet usage, entering into contract with a foreign supplier has

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30 OECD (1997) – *Electronic Commerce: The Challenges to Tax Authorities and Taxpayers* Page 6-7.

31 European Commission Directorate General XXI Customs and Indirect Taxation Document XXI/98/0359 3.4.1998 – *Interim Report on the Implications of Electronic Commerce for VAT and Customs* Page 7.

32 Hargitai, C. *Value Added Taxation of Electronic Supply of Services within the European Community*. Jean Monnet Working Paper 13/01

33 Lamensch, M., “Reverse charging” and the “one-stop-shop-scheme”: collecting VAT on digital supplies. (2012) vol 1 issue 1 World Journal of VAT/GST Law. Page 1.

become increasingly feasible for consumers. Traditional VAT systems are in many cases incapable of catching these foreign transactions to consumers.<sup>34</sup>

Moreover, the evasive nature of electronic commerce results in significant difficulties for tax administrations. Traditional VAT systems require suppliers identify the tax status and location of their customers in order for them to fulfil their administrative and payment obligations. In lack of compliance, enforcement would be based on the tax authority's knowledge of the identity and location of the supplier. In a conventional trade environment that would be relatively unproblematic since trade partners met in person and supplies travelled through physical checks.<sup>35</sup> However, online deals are concluded on an interactive basis, anonymously and unconstrained by time, space and borders. Electronic services are available at any moment, almost instantaneously and in an automated way.<sup>36</sup> These aspects make it almost impossible to identify and locate the supplier and the customer.

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34 Hargitai, C. *Value Added Taxation of Electronic Supply of Services within the European Community*. Jean Monnet Working Paper 13/01

35 Hargitai, C. *Value Added Taxation of Electronic Supply of Services within the European Community*. Jean Monnet Working Paper 13/01

36 Lamensch, M. *Unsuitable EU VAT Place of Supply Rules for Electronic Services – Proposal for an Alternative Approach*. World Tax Journal. February 2012. Page 78.

# 4 Taxation of Electronic Services

## 4.1 Introduction

In January 2008 the EU Council adopted the so called VAT package. The package consists of two directives and one regulation and results in numerous changes to the VAT Directive.<sup>37</sup>

The provisions on the place of supply are decisive for in which country a supply shall be taxed in case of cross-border transactions. Due to globalisation and technology change more and more services are provided remotely and the provisions in the VAT Directive have not been suited for this purpose. Directive 2008/8/EC was adopted to meet these challenges. The purpose of the changes is to, to a greater extent, achieve taxation in the land of consumption in order to maintain the fundamental principle that the land of consumption should levy the tax.<sup>38</sup>

In March 2011 the Council adopted the Council Implementing Regulation (EU) No 282/2011.<sup>39</sup> In October 2012 and October 2013 the changes were made to the Implementing Regulation in order to adapt it to the provisions of Directive 2008/8/EC that will enter into force 1 January 2015. The Implementing Regulation is directly enforceable in the Member States and, thus, does not need to be implemented into domestic law.<sup>40</sup>

In its press release of 18 December 2012 the Commission communicated that a final proposal concerning the taxation of telecommunications, broadcasting and electronic services fairer and more business friendly as of 1 January 2015. Accordingly, the VAT Directive will be modified in order to encounter the development of e-commerce. One of the major changes is that these services will be taxed where the customer is established or resides. The aim is that the new rules will provide a level playing field for all businesses in the sectors

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<sup>37</sup> Promenoria *Nya mervärdesskatteregler om omsättningsland för telekommunikationstjänster, radio- och tvsändningar och elektroniska tjänster*, Dnr Fi2013. Page 32

<sup>38</sup> Preamble to COUNCIL DIRECTIVE 2008/8/EC of 12 February 2008 amending Directive 2006/112/EC as regards the place of supply of services

<sup>39</sup> Council Implementing Regulation No 282/2011 of March 2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax.

<sup>40</sup> Promenoria *Nya mervärdesskatteregler om omsättningsland för telekommunikationstjänster, radio- och tvsändningar och elektroniska tjänster*, Dnr Fi2013. Page 33.

concerned – regardless of their size or corporate structure – and thus contribute to the development of e-commerce in the single market.<sup>41</sup>

In order to ensure simple compliance, the suppliers of these services will be able to comply their VAT obligation in the whole of EU by submitting a single VAT return in the Member State of identification. For the customer the VAT rate will be the same regardless of where the supplier is established.<sup>42</sup>

## **4.2 The EU VAT Place of Supply Rules for Electronic Services**

### **4.2.1 The Provisions**

The place of supply in B2B transactions is where the receiver has established his business. However, if the services are provided to a fixed establishment of the taxable person located in a place other than the place where he has established his business, the place of supply of those services shall be the place where that fixed establishment is located. In absence of such place of establishment or fixed establishment, the place of supply of services shall be the place where the taxable person who receives such services has his permanent address or usually resides. This is actually nothing else than the application of the standard rule for B2B supplies.<sup>43</sup>

The standard rule in case of a B2C transaction provide that the place of supply is deemed to be where the supplier has established his business. However, if the services are provided to a fixed establishment of the taxable person located in a place other than the place where he has established his business, the place of supply of those services shall be the place where that fixed establishment is located. In absence of such place of establishment or fixed establishment, the place of supply of services shall be the place where the taxable person who receives such services has his permanent address or usually resides. This is what applies in case of intra-Community supplies of electronic services until 1 January 2015.<sup>44</sup>

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<sup>41</sup> *VAT: taxation of telecommunications, broadcasting and electronic services* 18/12/2012 / Taxation and Customs Union DG

<sup>42</sup> *Ibid.*

<sup>43</sup> Article 44 RVD

<sup>44</sup> Article 45 RVD



When electronic services are supplied to private customers residing in the EU by a taxable person who has established his business outside the EU or has a fixed establishment there from which the services are supplied, or who, in absence of such a place of business or fixed establishment, has his permanent address or usually resides outside the Community, shall be where the private customer is established, or where he has his permanent address or usually resides. The mere communication between the supplier and the customer through e-mail does not constitute an electronically supplied service.<sup>45</sup>

Where electronic services are supplied by an EU e-supplier to a private customer who is established or has his permanent address or usually resides outside the Community, the place of supply shall be where the private customer is established, has his permanent address or usually resides.<sup>46</sup>

In addition to that, in order to prevent double taxation, non-taxation or distortion of competition, Member States may, with regard to, inter alia, B2B supplies and B2C supplies:

(a) consider the place of supply of any or all of those services, if situated within their territory, as being situated outside the Community if the effective use and enjoyment of the services takes place outside the Community;

(b) consider the place of supply of any or all of those services, if situated outside the Community, as being situated within their own territory if the effective use and enjoyment of the services takes place within their territory.

However, this shall not apply to the electronically supplied services where those services are rendered to non-taxable persons not established within the Community. It should also be noted that this does not apply when electronic services are supplied by non-EU e-suppliers to private customers residing in the EU.<sup>47</sup>

An overview of the place of supply of electronic services is provided in the table below.

**Table 1**

Type of transaction	Place of supply	Article
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45 Article 58 RVD

46 Article 59 RVD

47 Article 59a RVD.

Intra-community e-supply to private customer	Where the supplier is established or has a fixed establishment from where the services are provided	Article 45 (default rule)
Supply to EU private customer by a non-EU e-supplier	Where the EU private customer is established, has a permanent address or usually resides	Article 58
Supply by EU e-supplier to non-EU consumers	Where the non-EU private customer is established, has a permanent address or usually resides (i.e. no EU VAT)	Article 59
E-supply to business customers	Where the customer is established or has a fixed establishment. In absence of such, where the receiver usually resides or has his permanent address.	Article 44
Supply by EU e-supplier to private and business customers - does not apply to electronically supplied services when rendered to non-taxable persons established outside the EU nor to electronic services supplied by non-EU e-suppliers to EU private customers	In order to prevent double taxation, non-taxation or distortion of competition, and in order to tax, when possible, where consumption actually occurs Member States may switch the place of supply to where it is “efficiently use and enjoyed”	Article 59a

As of 1 January 2015, Article 58 of the VAT Directive will be changed so that the place of supply of, inter alia, electronic services to non-taxable persons, whether or not established within the Community, will be where those persons are established, have their permanent address or usually reside. In addition to that, the “efficient-use-and-enjoyment” clause in Article 59a will be extended so that it also applies to electronically supplied services when rendered to non-taxable persons established outside the EU. It will also apply on electronic supplies to EU private customers by non-EU e-suppliers. This is illustrated in Table 2.

**Table 2**

<b>Type of transaction</b>	<b>Place of supply</b>	<b>Article</b>
Intra-Community e-supply to private customer	Where the EU private customer is established, has a permanent address or usually resides	Article 58
Supply by EU e-supplier to non-EU private customer	Where the non-EU private customer is established, has a permanent address or usually resides (i.e. no EU VAT)	Article 58
Supply by EU and non-EU e-supplier to private and business customers	In order to prevent double taxation, non-taxation or distortion of competition, and in order to tax, when possible, where consumption actually occurs Member States may switch the place of supply to where it is “efficiently use and enjoyed”	Article 59a

## 4.2.2 Remarks

If the situation prior to the implementation of a VAT regime on electronic supplies was disadvantageous for EU e-suppliers, the current rules, in principle, are more favourable to EU e-suppliers than to non-EU suppliers. While EU e-suppliers can charge the same VAT rate to every EU non-taxable person, non-EU e-suppliers are required to keep track of the location of their customers in order to properly apportion taxes and they need to know the rate to apply at those locations. It can be questioned whether the customer actually can be located but assuming that that is the case, the second requirement, although cumbersome, can be complied with.<sup>48</sup> In practice, this can be circumvented. By opening a subsidiary or a fixed establishment in an EU Member State with a low tax rate, like Luxembourg, so that they can operate in the Community under the same conditions as EU e-suppliers.<sup>49</sup> By taxing all electronic supplies at destination, as will be the case from 1 January 2015, this perceived discrimination of non-EU e-suppliers will be removed, and so will the incentive for e-suppliers to establish themselves in jurisdictions with low tax rate.

The use of an efficient-use-and-enjoyment clause has been heavily criticised by Lamensch and Ecker. Lamensch contends that, in a digital context, characterised by the absence of any contact between the parties and instantaneous transactions, and due to the nature of online services, which do not allow for locating of customers, she cannot see how e-suppliers possibly could be able to determine whether an electronic service has been effectively used and enjoyed at the place where it was supplied.<sup>50</sup>

Ecker is even more thorough in his criticism. He argues that, by introducing adopting the efficient-use-and-enjoyment clause, the EU legislature has taken a 40 year leap back in the evolutionary process and ignored the fact that international experience has proved that such a criterion is not effective for taxing services. He notices that the concept of use and enjoyment as the decisive factor for allocating taxing rights between Member States was used already in

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48 Van der Merwe, B.A., *VAT in the European Union and Electronically Supplied Services to Final Consumers*, (2004) South African Mercantile Law Journal, no. 16, Page 583.

49 Parilli, *European VAT and Electronically supplied services*.  
-[http://www.itdweb.org/documents/European\\_VAT\\_and\\_Electronically\\_Supplied\\_Services\\_DPTI\\_010908.pdf](http://www.itdweb.org/documents/European_VAT_and_Electronically_Supplied_Services_DPTI_010908.pdf) Page 12

50 Lamensch, M. *Unsuitable EU VAT Place of Supply Rules for Electronic Services – Proposal for an Alternative Approach*. World Tax Journal. February 2012. Page 85.

the Second VAT Directive<sup>51</sup> but that it was soon discovered that it was impractical. Consequently, it was abandoned in favour of presumptions (proxies) on the place of consumption.<sup>52</sup>

The rationale for reviving a pure efficient-use-and-enjoyment clause, Ecker points out, is to combat non-taxation and prevent double taxation of services. However, it is not always possible or practical to determine the place where services are used and enjoyed. It is not always the party that buys the services that actually uses and enjoys the service. Moreover, services, such as electronic services, are not necessarily used immediately and they can be used for a longer period of time at various places. Ecker also calls for a definition of the term “use and enjoyment”. He also observes that the clause as such gives each Member State discretionary powers to overrule the place of supply of services. In certain cases, Member States may have conflicting views on where a place is effectively used and enjoyed, which could lead to disharmonisation and double taxation, something that has occurred in the past. Ecker concludes that the place of efficient-use-and-enjoyment is neither clear nor simple, efficient, or practical as an allocation rule. Instead he advocates the development of proxies to determine the place of consumption of services. He notes that such proxies have already been developed by the ECJ in the *Athesia Druck*<sup>53</sup> case in respect of advertising services.<sup>54</sup>

## 4.3 Implementing Regulations

### 4.3.1 Introduction

In doctrine, concern has frequently been raised against the EU's attempt to tax electronic services at the place of consumption due to the difficulties e-suppliers have in identifying the status and the location of the customer. Implementing Regulation 282/2011<sup>55</sup> address these issues, laying down guidelines for how the

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51 Second Council Directive 67/228/EEC of 11 April 1967 on the harmonization of legislation of Member States concerning turnover taxes – Structure and procedures for application of the common system of value added tax

52 Ecker, T. *Place of Effective Use and Enjoyment of Services – EU History Repeats Itself*. International VAT Monitor November/December 2012. Page 407-410.

53 C-1/08 *Athesia Druck*

54 Ecker, T. *Place of Effective Use and Enjoyment of Services – EU History Repeats Itself*. International VAT Monitor November/December 2012. Page 407-410.

55 Council Implementing Regulation (EU) No 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax

status and the location of customers are to be determined. The changes introduced by Implementing Regulation 282/2011 enters into force 1 January 2015.

Numerous new provisions are introduced by Implementing Regulation (EU) No. 1042/2013<sup>56</sup> in order to clarify and simplify the application of the place of supply rules. If the new provisions are uniformly applied, double taxation or double non-taxable is avoided.

Since it is the supplier that is obliged to account for and pay the tax to the Member State where the customer is established, has his permanent address or usually resides, it is important to establish who the supplier is and, thus, who is obliged to account for and pay the tax. It is also of importance to determine in which country the customer is established, has his permanent address or usually resides and, consequently, to which Member State the tax ought to be accounted for and paid to and at which rate. There is also a need for uniform rules to clarify which country has the right to tax where the customer is established in two countries. Moreover, there is a need to clarify how to determine the country of taxation when it is difficult, or practically almost impossible, for a supplier to identify where his customer is established, has a permanent address or usually resides.

Implementing Regulation 1042/2013 enters into force 1 January 2015.<sup>57</sup>

### **4.3.2 Status of the customer**

The VAT status of the customer will be of importance from 2015 for establishing the liability to remit VAT to the tax authorities in relation to intra-community supplies of electronic services. As cross-border B2B supplies are subject to the reverse charge mechanism, the e-supplier is not liable to remit VAT on those supplies. Conversely, e-suppliers must remit VAT on B2C supplies to the tax authorities.

The Implementing Regulation provides several clarifications in respect of the status of the customer. Accordingly, an e-supplier may treat a customer established within the EU as a taxable person when (i) the customer has communicated his individual VAT identification number to him and the

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<sup>56</sup> COUNCIL IMPLEMENTING REGULATION (EU) No 1042/2013 of 7 October amending Implementing Regulation (EU) No 282/2011 as regards the place of supply of services.

<sup>57</sup> Article 3 Implementing Regulation 1042/2013

supplier obtains confirmation of the validity of that identification number and of the associated name and address<sup>58</sup>, (ii) where the customer has not yet received an individual VAT identification number, but informs the supplier that he has applied for it and the supplier obtains any other proof which demonstrates that the customer is a taxable person or a non-taxable legal person required to be identified for VAT purposes and carries out a reasonable level of verification of the accuracy of the information provided by the customer, by normal commercial measures such as those relating to identity and payment checks.<sup>59</sup> Irrespective of information to the contrary, the supplier of electronic services may regard a customer established within the Community as a non-taxable person as long as that customer has not communicated his individual VAT identification number to him. (It is likely that information to the contrary refers to scenario (ii) above.)<sup>60</sup> So in effect, the line between B2B and B2C services will depend on whether the customer has given the e-supplier his VAT identification number or not.

In case of a customer established outside the Community, the e-supplier may regard that customer as a taxable person (i) if he obtains from the customer a certificate issued by the customer's competent tax authorities as confirmation that the customer is engaged in economic activities in order to enable him to obtain a refund of VAT<sup>61</sup>, (ii) where the customer does not possess that certificate, if the supplier has the VAT number, or a similar number attributed to the customer by the country of establishment and used to identify businesses or any other proof which demonstrates that the customer is a taxable person and if the supplier carries out a reasonable level of verification of the accuracy of the information provided by the customer, by normal commercial security measures such as those relating to identity or payment checks. This apply unless the e-supplier has information to the contrary.<sup>62</sup>

### **4.3.3 Locating the customer**

It is essential to locate the customer in order to establish the cross-border nature of a supply. As discussed above, e-supplies to business customers will be taxed where that person has his place of establishment, a fixed establishment or

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58 Article 18(1)(a) Implementing Regulation 282/2011

59 Article 18(1)(b) Implementing Regulation 282/2011

60 Article 18(2) as amended by Implementing Regulation 1042/2013

61 Article 18(3)(a) Implementing Regulation 282/2011

62 Article 18(3)(b) Implementing Regulation 282/2011

his permanent address and usual residence. As of 2015, the e-suppliers must, where the customer is established in a single country or has his permanent address or usually resides in a single country, determine where that place is located based on the information received from their customers. The e-supplier must then verify that information in accordance with normal commercial security measures such as those relating to identity or payment checks. That information may include a VAT identification number.<sup>63</sup>

If the business customer is established in more than one country, the supply will be taxed in the country where the customer has established his business. However, where the service is provided to a fixed establishment of the taxable person located in a place other than that where the customer has established his business, that supply shall be taxable at the place of the fixed establishment receiving that service and using it for its own needs. Where the taxable person does not have a place of establishment of a business or a fixed establishment, the supply shall be taxable at his permanent address or usual residence.<sup>64</sup>

The place where a taxable person has established his business shall be the place where the functions of the business's central administration is carried out.<sup>65</sup> In order to determine that place, account shall be taken of the place where essential decisions concerning the general management of the business are taken, the place where the registered office of the business is located and the place where the management meets. In case these criteria do not allow the place of establishment of a business to be determined with certainty, priority shall be given to the place where essential decisions concerning the general management of the business are taken.<sup>66</sup> It should be noted that the mere presence of a postal address cannot constitute the place of establishment of a business of a taxable person.<sup>67</sup>

A fixed establishment is “any establishment other than the place where the taxable person has established his business characterised by a certain degree of permanence and suitable structure in terms of human and technical resources to enable it to receive and use the services supplied to it for its own needs or to

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63 Article 20 Implementing Regulation No. 282/2011

64 Article 21 Implementing Regulation 282/2011

65 Article 10(1) Implementing Regulation 282/2011

66 Article 10(2) Implementing Regulation 282/2011

67 Article 10(3) Implementing Regulation 282/2011



provide the services which it supplies”.<sup>68</sup> It is clear that this definition derives from the case law of the ECJ.<sup>69</sup> Nevertheless, as Lejeune, Cortvriend and Accorsi points out, there are some differences between them as the case law is limited to fixed establishments of services providers. Moreover, according to the ECJ, a fixed establishment must be fully dependent on the taxable person's main office and treating the taxable person's presence as a fixed establishment must produce a “rational result”. These aspects have not been included in the definition provided by the Implementing Regulation.<sup>70</sup>

In order to identify the customer's fixed establishment to which the service is provided the supplier shall examine the nature and use of the service provided. Where the nature and use of the service provided do not enable him to identify the fixed establishment to which the service to which the service is provided, the supplier, in identifying that fixed establishment, shall pay particular attention to whether the contract, the order form and the VAT identification number attributed by the Member State of the customer and communicated to him by the customer identify the fixed establishment as the customer of the service and whether the fixed establishment is the entity paying for the service.<sup>71</sup>

Where the fixed establishment cannot be established according to the abovementioned or the the services are supplied to a taxable person under a contract covering one or more services used in an unidentifiable and non-quantifiable manner, the supplier may legitimately consider that the services have been supplied at the place where the customer has established his business.<sup>72</sup>

If the customer has neither a place of establishment of a business nor a fixed establishment, the supply shall be taxable at his permanent address or his usual residence.<sup>73</sup>

The “permanent address” of a natural person, whether taxable or not, shall be the address entered into the population or similar register, or the address

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68 Article 11 Implementing Regulation 282/2011

69 See, for instance, C-168/84 *Berkholz*, C-231/94 *Faaborg-Gelting Linien*, C-190/95 *ARO Lease*, C-260/95 *DFDS*, C-390/96 *Lease Plan Luxembourg* and C-73/06 *Planzer Luxembourg*

70 Lejeune, I., Cortvriend, E., and Accorsi, D., *Implementing Measures Relating to EU Place-of-Supply Rules: Are Business Issues solved and Is Certainty Provided?* International VAT Monitor. May/June 2011. Page 146.

71 Article 22 Implementing Regulation 282/2011

72 Article 22 Implementing Regulation 282/2011

73 Article 21 Implementing Regulation 282/2011

indicated by that person to the relevant tax authorities, unless there is evidence that this address does not reflect reality.<sup>74</sup>

The place where a natural person, whether taxable or not, “usually resides” shall be the place where that natural person usually lives as a result of personal or occupational ties. If the occupational ties are in a country different from that of the personal ties, or if no occupational ties exist, the place of usual residence shall be determined by personal ties which show close links between the natural person and the place where he is living.<sup>75</sup>

In respect of supplies made to EU private customers by non-EU e-suppliers or by EU e-suppliers to non-EU private customers, the place of supply shall be where the private customer is established, or, in absence of an establishment, where the customer has his permanent address or usually resides. The e-supplier shall establish that place based on factual information provided by the customer, and verify that information by normal commercial security measures such as those relating to identity or payment checks.<sup>76</sup>

Article 24(2) of Implementing Regulation 282/2011 provided that where a non-taxable person is established in more than one country or has his permanent address in one country and his usual residence in another, priority shall be given to the place that best ensures taxation at the place of actual consumption when determining the place of supply of those services.<sup>77</sup> However, this provision has already been replaced by a new Article 24, provided by Implementing Regulation 1042/2013. The new Article 24 provides for an order of priority when locating a customer who is established in more than one country or whose permanent address and usual residence differ. Accordingly, in case of a non-taxable legal person, priority shall be given to the place where the functions of the central administration are carried out (i.e. where the business is established), unless there is evidence that the service is used at the place of any other establishment characterised by a sufficient degree of permanence and a suitable in terms of human and technical resources to enable it to receive and use the services supplied to it for its own needs, ( i.e. a fixed establishment).<sup>78</sup>

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74 Article 12 Implementing Regulation 282/2011

75 Article 13 Implementing Regulation 282/2011

76 Article 23(2) Implementing Regulation 282/2011.

77 Article 24(2) Implementing Regulation 282/2011

78 Article 24(a) as provided by Implementing Regulation 1042/2013

In respect of supplies to a non-taxable natural person, the place of usual residence shall be given precedence over the permanent address unless there is evidence that the service is used at this, latter, place.<sup>79</sup>

The aim of this provision is to avoid conflicts concerning jurisdiction between Member States.<sup>80</sup>

#### **4.3.4 Presumptions to determine where the customer is established, has his permanent address or usually resides**

The new Articles 24a, 24b, 24d and 24f in the Implementing Regulation contain presumptions and rules of evidence in order to simplify the application of the place of supply rules for, inter alia, electronic services where it is unclear where the customer is established, has his permanent address or usually resides and, hence, where the service is supposed to be taxed. The purpose of the rules is thus to minimise the risk that situations of either double taxation or non-taxation arise. All of the presumptions may, under certain circumstances, be overruled.

A company which has accounted for and paid VAT in a Member State under one of the presumptions is protected from any requirements to pay VAT from the other Member States, if it acted in good faith.

Article 24a.1 provides that electronic services supplied at a certain place, where the customer must be physically present to use the service (for example, a phone booth, an internet café or a hotel lobby) the service is considered to have been supplied to that place.<sup>81</sup> This applies to transactions involving taxable persons as well as non-taxable persons. In these cases the supplier usually has not had any previous contact with the customer and, thus, it may be practically impossible for the supplier to identify who the customer is or where he is established, has his permanent address or usually resides. Moreover, such transactions often concern small amounts of money. Under such circumstances it would be a disproportionate burden for companies to obtain complete data in

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<sup>79</sup> Article 24(b) as provided by Implementing Regulation 1042/2013

<sup>80</sup> COM(2012) 763 FINAL - Explanatory Memorandum to Implementing Regulation 282/2011.

<sup>81</sup> Article 24a.1 Implementing Regulation 1042/2013

order to determine the customer's real establishment, permanent address or usual residence.<sup>82</sup>

Article 24a.2 provides that, if the place referred to in paragraph 1 is on board a ship, an aircraft or a train under a personal transport, the place of supply shall be the country of departure for that personal transport.<sup>83</sup>

It must be pointed out that the presumption in Article 24a only applies in those instances where the customer must be present at a particular place to be able to receive the service. Hence, the presumption does not cover the services that the train passenger acquires through the access of internet, i.e. the downloading of games or films.

Article 24b a-c enumerate three different presumptions for telecommunications services, radio and television broadcasting services and electronic services supplied to non-taxable persons. If the services are supplied through a fixed land line, they are presumed to have been supplied at that place where the fixed land line is installed.<sup>84</sup>

If the service is supplied via a mobile network, it shall be presumed that the place where the customer is established, has his permanent establishment or usually resides is the country identified by the mobile country code of the SIM card used when receiving those services.<sup>85</sup> This presumption applies both where the customer uses a prepaid SIM card and where the customer uses a mobile subscription. As a general, there is no collection of personal details upon the sale of a prepaid SIM card, the e-supplier will not know who that customer is. Therefore the country of issue of the SIM card is key to establish where the customer is. In case of a mobile subscription, the e-supplier may know the customer. Thus the Explanatory Memorandum states that there needs to be scope for the country of issue presumption to be rebutted in these cases.<sup>86</sup>

Finally, there is a presumption for where it is necessary to use a decoder or a similar device or a viewing card is needed and a fixed land line is not used. In those instances the place of supply is presumed to be where the decoder actually is or, if that place it not known, where the viewing card has been sent.<sup>87</sup>

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82 COM(2012) 763 FINAL - Explanatory Memorandum to Implementing Regulation 282/2011.

83 Article 24a.2 Implementing Regulation 1042/2013

84 Article 24b(a) Implementing Regulation 1042/2013

85 Article 24b(b) Implementing Regulation 1042/2013

86 COM(2012) 763 FINAL - Explanatory Memorandum to Implementing Regulation 282/2011.

87 Article 24b(c) Implementing Regulation 1042/2013

In situations other than those referred to in Article 24a and 24b a-c, the customer is presumed to be established, to have his permanent address or to usually reside at the place identified as such by the supplier on the basis of two items of non-contradictory evidence as listed in Article 24f of the Regulation. This includes (a) the billing address of the customer, (b) the IP address of the device used by the customer or any method of geolocation, (c) bank details such as the location of the bank account used for payment or the billing address of the customer held by the bank, (d) the Mobile Country Code (MCC) of the International Mobile Subscriber Identity (IMSI) stored on the SIM card used by the customer and (e) the location of the customer's fixed land line through which the service is supplied to him. Since a number of different business models have been developed, the listing is not exhaustive. It is indicated in subparagraph (f) that it is meant to be flexible since it contains the phrase "other commercially relevant information."<sup>88</sup> Merkx remarks in respect of this provision, that it does not, in case of contradiction, indicate how the customer's location must be determined. There is no priority order or majority rule. She also points out that specific forms of evidence can be manipulated, for instance a bank account can be held abroad and an IP address can be manipulated.<sup>89</sup>

As regards the other presumptions in Article 24a and Article 24b a-c, the supplier has a possibility to rebut these if he has three items of evidence that all indicate that the customer is established, has his permanent address or usually resides somewhere else.<sup>90</sup> Furthermore, the presumptions can be rebutted in case of abuse. Hence, if it follows from the factual circumstances that the main purpose of the transactions is to gain tax benefits, the presumptions do not apply.<sup>91</sup>

#### **4.3.5 Presumptions to establish who the supplier is in case of intermediation**

According to Article 28 of the VAT Directive an intermediate that acts in his own name but on the behalf of someone else is considered to have received and supplied the service which the intermediation concerns. Article 28 brings about

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<sup>88</sup> Article 24f Implementing Regulation 1042/2013

<sup>89</sup> Merkx, M. *New Implementing Measures for EU Place-of-Supply Change 2015*. International VAT Monitor. July/August 2013

<sup>90</sup> Article 24d.1 Implementing Regulation 1042/2013

<sup>91</sup> Article 24d.2 Implementing Regulation 1042/2013

a legal fiction that two identical services are supplied after one another. On the other hand, if the intermediate acts in the name and on the behalf of someone else, the principal supplier is considered to have supplied the services directly to the customer while the intermediate is considered to have supplied an intermediation service.

The new Article 9a.1 of the Implementing Regulation provides that he who supplies electronic services through an interface, a web portal or a telecommunications network is presumed to have acted in his own name, unless the principal explicitly is indicated as the supplier and that is also expressed in the contract. This means that, as a presumption, when supplying electronic services on an internet marketplace, so called applications, it is the marketplace, and not the the producer, that is considered to supply the service to the customer. The producer is, rather, considered to have supplied the service to the marketplace.<sup>92</sup>

In order for the principal to be considered to have explicitly been indicated as the supplier, a number of conditions must be fulfilled. In case an invoice has been issued or made available, the invoice should indicate the service and the supplier of it. If no invoice has been issued, the same information should be indicated on the bill or the receipt. The intermediate may not be the one who “governs” the sale. For instance, if the supply cannot be conducted without the consent of the intermediate, the intermediate is considered to act in his own name. The same applies if it is the intermediate that authorises the debiting of the customer or sets the general terms and conditions of the supply. Finally, the principal must be indicated as the supplier in the contract.<sup>93</sup>

In case of a distribution chain, these conditions must be fulfilled in each part of the transaction chain.

Article 9a.3 clarifies that companies that merely provides for processing of payments in respects of electronically supplied services and who does not take part in the supply of those services are not considered to be intermediates.<sup>94</sup>

Article 9a covers supplies to both taxable and non-taxable persons.

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92 Article 9a.1 Implementing Regulation 1042/2013

93 Article 9a.1 Implementing Regulation 1042/2013

94 Article 9a.3 Implementing Regulation 1042/2013

### **4.3.6 Hotels and similar businesses**

Pursuant to Article 31c of the Implementing Regulation, telecommunications services, radio and television broadcastings and electronic services supplied by a hotel in connection to the supply of accommodation at the hotel are deemed to be supplied where the hotel is situated. The same applies on businesses with a similar purpose, for instance camping places. The provision applies on B2B and B2C transactions. It is applicable when the hotel acts in its own name when supplying the services. The purpose of the provision is to simplify for the companies. It is not a presumption and, therefore, the rules of evidence in articles 24d and 24f are not applicable. However, if it is clear that the services are not supplied in connection with the supply of an accommodation, they are covered by the presumptions. An example of this could be the supply of a hotspot in the lobby of the hotel without any connection to the supply of accommodation.<sup>95</sup>

### **4.3.7 Remarks**

It is clear that the e-suppliers reception of the customer's VAT identification number is crucial for determining the status of the customer in case of B2B e-supplies within the EU. The wording of the amended Article 18(2) implies that even if the customer provides proof that demonstrates his status as a taxable person, the e-supplier can choose to treat him as a non-taxable person. As the e-suppliers carry the burden to conduct a “reasonable level of verification of the accuracy of the information provided by the customer, including by relying on identity or payment checks”, it can be questioned if an e-supplier will make the effort to conduct such a research, especially when expected to do so on a per-transaction basis, when they simply can escape that responsibility by treating the customer as a non-taxable person.

The e-supplier is expected to do a similar verification of information provided by the customer in respect of outbound supplies of electronic services. The difference lies in that in these cases the e-supplier must assess the information that the customer provides.

So, in absence of a VAT identification, or “any other proof”, the customer will be treated as a private customer. Lamensch points out that there is no criteria for

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<sup>95</sup> Article 31c Implementing Regulation 1042/2013

how to interpret “any other proof”, thus resulting in legal uncertainty. In addition to that, considering the immediacy of electronic supplies, it is necessary that information is provided on a real-time basis. This may be possible when a customer provides a valid VAT number, but it is doubtful whether that is the case in respect of “other proof”.<sup>96</sup> In this respect it is interesting to see that, according to a client survey conducted by PwC UK in 2010, it was revealed that 78% of the respondents actually obtain their customers’ VAT identification number or other proof as to whether the customer is a taxable person or VAT purposes and, of those who obtain that number, only 50% of the respondents take the trouble of verifying at a “reasonable level” the validity of the information received. Many respondents considered it difficult or even very difficult to verify the information, in particular by means of “existing commercial security measures”.<sup>97</sup>

Several questions arise in respect of the location of the customer. For instance, where the customer is established in more than one country, it is unclear under which circumstances fixed establishments use services for their own need and, even more so, how e-suppliers are to determine when that criterion is fulfilled. Disagreement might also arise between the e-supplier and the customer in respect of this criterion.<sup>98</sup> Furthermore, it can also be questioned how on earth an e-supplier is expected to determine whether a fixed establishment has “a sufficient degree of permanence and a suitable structure in terms of human and technological resources to receive and use the service”.<sup>99</sup>

Lamensch also criticises the wording of Article 24(2), that the “place that best ensures taxation at the place of actual consumption” shall be determinant for where a customer is deemed to be established. As there seldom are any official and verifiable elements of verification available in respect of private customers, she questions whether this criterion is implementable at all.<sup>100</sup> Even though this provision has been given a new wording containing a priority of order, I think that this issue remains relevant.

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96 Lamensch, M., *Unsuitable EU VAT Place of Supply Rules for Electronic Services – Proposal for an Alternative Approach*, World Tax Journal. February 2012.

97 Lejeune, I., Cortvriend, E., and Accorsi, D., *Implementing Measures Relating to EU Place-of-Supply Rules: Are Business Issues solved and Is Certainty Provided?* International VAT Monitor. May/June 2011. Page 147.

98 Ibid. Page 149.

99 Lamensch, M., *Unsuitable EU VAT Place of Supply Rules for Electronic Services – Proposal for an Alternative Approach*, World Tax Journal. February 2012.

100 Ibid.



To conclude, it seems like the compliance burden on the e-supplier is quite high, indeed so high that they may exceed the benefit of many electronic supplies.

## **4.4 Collection Mechanisms**

### **4.4.1 Introduction**

In order to facilitate the compliance burden of suppliers the VAT Directive provides for two different collection mechanisms – reverse charging and a one-stop-shop scheme. The former applies to B2B supplies while the latter applies to B2C supplies.

### **4.4.2 Reverse Charge**

As mentioned above, cross-border B2B supplies of electronic services are deemed to be made where the customer is established. According to the main rule, VAT is payable by any taxable person carrying out a supply of goods or services.<sup>101</sup> However, derogating from the main rule, Article 196 RVD provides that VAT shall be payable by any business customer to whom services are supplied, if the services are supplied by a taxable person not established within the territory of the Member State. So in effect, the reverse charge mechanism transfers the tax obligation to the receiver of the service.<sup>102</sup> Moreover, EU service providers must periodically report the customer's VAT identification numbers and the value of the services supplied in the reporting period to the tax authorities through a recapitulative statement. That information is then transferred through the VIES<sup>103</sup> to the tax authorities of the customer's Member State which checks whether the customer actually has accounted for VAT on the purchase of the services abroad.<sup>104</sup>

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101 Article 193 RVD

102 Article 196 RVD

103 VAT Information Exchange System

104 Merckx, M. *New Implementing Measures for EU Place-of-Supply Change 2015*. International VAT Monitor. July/August 2013

### 4.4.3 One-Stop-Shop Scheme

Under the current place of supply rules for electronic services, non-EU e-suppliers have to register and remit the VAT due on their supplies in each Member State in which they have private customers. Obviously, this creates a significant compliance burden for the e-suppliers. Reverse charging is not an option in B2C supplies since private customers are not registered for VAT purposes and they have neither the skills to voluntarily proceed to the remittance of the tax nor any incentive to do so as they have to bear the economic burden of the tax without any possibility of recovering it.<sup>105</sup>

In order to facilitate the compliance burden for non-EU suppliers of electronic services to EU private customers, the VAT Directive provides an optional special scheme.<sup>106</sup> The special scheme for electronically supplied services is found in Articles 357-369 RVD.

Under the special scheme, non-EU e-suppliers supplying electronic services to EU private customers shall register and obtain a VAT identification number in the “Member State of identification”. The non-EU e-supplier shall state to the Member State of identification when he commences or ceases his activity as a taxable person, or changes that activity in such way that he no longer meets the conditions necessary for use of the special scheme.<sup>107</sup> The Member state of identification shall allocate to the non-EU e-supplier an individual VAT identification number.<sup>108</sup> The e-supplier will be in contact only with the tax authorities of the Member State of identification and shall submit by electronic means to the Member State of identification a VAT return for each calendar quarter, whether or not electronic services have been supplied.<sup>109</sup> The VAT return shall show the identification number and, for each Member State of consumption in which VAT is due, the total value, exclusive of VAT, of supplies of electronic services carried out during the tax period and the total amount of corresponding VAT. The applicable rates of VAT and the total VAT due must

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105Lamensch, M., *“Reverse charging” and the “one-stop-shop-scheme”*: collecting VAT on digital supplies. (2012) vol 1 issue 1 World Journal of VAT/GST Law.

106Preamble to Council Directive 2002/38/EC

107Article 360 RVD

108Article 362 RVD

109Article 364 RVD

also be indicated on the return.<sup>110</sup> The e-supplier shall pay the VAT when submitting the VAT return.<sup>111</sup>

As intra-community supplies of electronic services to private customers will be taxed at destination from 1 January 2015, EU e-suppliers will face problems similar to them of non-EU e-suppliers. Therefore the one-stop-scheme will also be available to EU e-suppliers as of that date.

#### 4.4.4 Remarks

Reverse charging does indeed reduce the compliance burden of e-suppliers as it shifts the liability to assess and remit the correct amount of VAT to the business customer.

However, there are some drawbacks connected with reverse-charging too. One of the attractive features of the VAT is its relative self-enforcement which is believed to minimise abuse.<sup>112</sup> This is hampered by the reverse charge mechanism which, in effect, transforms the VAT into a retail sales tax.<sup>113</sup>

Moreover, reverse charging applies on certain supplies and not for others. This means that businesses, within their accounting system, must handle invoices for purchases issued on a reverse charge basis, invoices for sales on which reverse charging applies and, invoices issued for sales where reverse charging does not apply. This leads to an increased compliance burden and cost.<sup>114</sup>

Moreover, in order to rely on the reverse charge mechanism, it is necessary to determine the status and the location of the customer. It is questionable whether an e-supplier is able to do that on a real time basis.

The advantage of the one-stop-scheme is that it allows online suppliers to register once in the EU, have just one VAT number, and centralise their filing obligations in one jurisdiction.<sup>115</sup>

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110 Article 365 RVD

111 Article 367 RVD

112 Terra, Kajus, *A Guide to the European VAT Directives -Introduction to European VAT 2011*. IBFD 2011. Page 302

113 Lamensch, M., "Reverse charging" and the "one-stop-shop-scheme": collecting VAT on digital supplies. (2012) vol 1 issue 1 World Journal of VAT/GST Law.

114 Lamensch, M., "Reverse charging" and the "one-stop-shop-scheme": collecting VAT on digital supplies. (2012) vol 1 issue 1 World Journal of VAT/GST Law.

115 Lamensch, M., "Reverse charging" and the "one-stop-shop-scheme": collecting VAT on digital supplies. (2012) vol 1 issue 1 World Journal of VAT/GST Law.

However, suppliers must always pay VAT upon their returns, leading to a cash flow disadvantage.<sup>116</sup> Moreover, it is difficult to enforce the scheme due to the anonymity of electronic transactions. As of the end of 2011, 453 businesses had registered under the scheme, in other words a relatively low number compared with the millions of suppliers that are online. The problem lies in that it is impossible to identify supplies made to EU consumers. Hence, it is likely that many foreign e-suppliers do not register and declare their supplies without tax authorities being able to control and sanction them. Finally, the administrative burden is non-negligible as suppliers are obliged to file periodic returns whether or not any supplies have been made during that period.<sup>117</sup>

## 4.5 Summary

Under the current regime, all electronic supplies but intra-community supplies to non-taxable persons are taxed at destination. Nevertheless, in order to prevent double taxation, non-taxation or distortion of competition, and in order to tax, when possible, where consumption actually occurs Member States may switch the place of supply to where it is “efficiently used and enjoyed”. It must be noted, however, that this does not apply to electronically supplied services when rendered to non-taxable persons established outside the EU nor to electronic services supplied by non-EU e-suppliers to EU non-taxable persons. In order to facilitate the compliance burden for non-EU e-suppliers, who would otherwise have to register for VAT in every Member State in which they have customers, in respect of B2C transactions, these suppliers may opt for a special scheme under which they register for VAT in one “Member State of identification”. Accordingly, they will only have to comply with their VAT obligations in that Member State.

As of 1 January 2015, the above will change and all electronic will be taxed at destination. As a consequence of this, the special scheme will be extended to include also B2C supplies made by EU e-suppliers. The efficient-use-and-enjoyment clause will also be extended to include all electronic supplies.

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116 Article 368 RVD

117 Lamensch, M., *“Reverse charging” and the “one-stop-shop-scheme”*: collecting VAT on digital supplies. (2012) vol 1 issue 1 World Journal of VAT/GST Law.

The VAT Directive puts a significant compliance burden on the e-supplier under the destination principle as he is obliged to identify the status and locate customers on a per-transaction basis. It is indeed positive that attempts are made to increase clarity in this respect through the Implementing Regulations. However, criteria laid down there are rather complex and lack clarity so it is questionable if they will have any real effect. As regards the “effective-use-and-enjoyment”-criterion, it is doubtful if it will be implementable at all. In the end of the day, taxing electronic commerce at destination is not very feasible and the situation is likely to worsen as more services will be covered.

# 5 Alternative approaches

## 5.1 Should it be taxed at all?

As pointed out above, there are several issues that make e-commerce difficult to tax under a VAT regime. In particular, these issues are connected with the global nature of e-commerce and the difficulties to identify and locate the customer. These difficulties could give rise to fraud or tax evasion and possibly create situations of double taxation or non-taxation. In the light of those considerations, the question arises whether electronic services should be taxed at all?

In fact, when drafting the E-commerce Directive, the UK was sceptical about asserting taxing competence over businesses with not presence at all in the EU. The scepticism was based on the assumption that there were no effective means of forcing non-EU vendors and there was a danger of the system losing all credibility. Instead the UK suggested to remove electronic commerce from taxation within the EU all together. At the time non-EU e-suppliers were not subject to VAT on their EU supplies while the opposite applied for EU e-suppliers, thus creating a disadvantage for the latter group. Implementing the UK suggestion would, then, create a level playing field in terms of pricing but at the cost of VAT revenues. Such an approach also mirrored the prevailing view in the USA.<sup>118</sup>

By all means, the character of e-commerce makes it difficult to tax compared to its physical counterparts. However, to simply capitulate in the sight of these obstacles, as the UK suggested, is, in my opinion, not a reasonable option. First, it is likely that it would result in a significant revenue loss, in particular as electronic commerce develops and more and more trade is conducted over the internet or similar electronic networks. A paradigm shift is taking place and the electronic marketplace growing at the expense of the traditional ditto. Secondly, it would be contrary to the very nature of the VAT system which aims to ensure neutrality as to how economic operators choose to organise and conduct their businesses. It is probable that the exclusion of e-commerce would create an incentive for traders to choose to conduct their business over the internet over a

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118 Ivinson, J. *Why the EU VAT and E-commerce Directive does not work* International Tax Review (2003)

traditional way of operating their business even if both options would be just as viable if it was not for the difference in tax treatment. I believe that it is clear that electronic transactions fall under the scope of VAT as they have all the characteristics of a taxable transaction. They are supplied for consideration by businesses registered for VAT purposes to either other businesses or final customers just as their physical counterparts. Hence, there is no reason for them to be subject to a more beneficial tax treatment. Thirdly, another feature of the VAT system is that it aims to tax as broadly as possible. Excluding electronic commerce from the scope of VAT would counter this goal.

In the light of those considerations, I think that electronic commerce should be subject to VAT.

## 5.2 Taxation at Origin

As we have seen, taxing electronic services at destination brings about a significant compliance burden for e-suppliers due to the difficulties in identifying and locating customers in a digital environment. Switching to an origin-based taxation of electronic services would, arguably, solve these issues. However, such a system is not without drawbacks.

Accordingly, the fact that the tax rates differ between Member States could result in insufficient neutrality. Companies with limited rights to deduct input VAT would be given a tax incentive to purchase services from countries with lower tax rates. Private customers in countries with high tax rates would have an incentive to purchase from countries with low tax rates rather than from domestic service providers. In addition to that, the deduction of input VAT would be made by a tax that is paid in another Member State. Therefore, an origin-based system requires a way to transfer and balance tax revenues between the Member States.<sup>119</sup> Several proposals for an origin-based VAT has been made in the past, but no solution has been able to satisfy these issues.<sup>120</sup>

For the purposes of taxing electronic services, the adoption of an origin-based taxation would, in essence, constitute a leap back to the situation in the 1990s. Accordingly, EU VAT would be imposed on intra-community and the export of electronic services made by EU e-suppliers while no VAT at all would be levied

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119 Ståhl, Persson Österman, Hilling, Öberg, *EU Skatterätt*, Iustus förlag, Tredje upplagan, Uppsala 2011. Page 236.

120 Lamensch, M., *Are "reverse charging" and the "one-stop-scheme" efficient ways to collect VAT on digital supplies?* (2012) vol 1 issue 1 World Journal of VAT/GST Law. Page 14.

on the supplies made by a non-EU e-supplier. In effect, the competitive disadvantage of the EU e-suppliers would be recreated. Hence, taxing electronic services at origin is not a viable option. A mixed system, taxing EU e-suppliers at origin and non-EU e-suppliers at destination is essentially the situation today and it is not satisfying either.

### 5.3 Technological Solutions

Traditionally, the collection system of the EU VAT system has relied heavily on suppliers. This has been seen as inevitable as only suppliers were in the position to gather the necessary information in order to take the right tax decisions, based on the nature of the supply, identity of the customer with whom they had physical contact. Due to the technological developments this has changed, in particular with regard to electronic supplies. The difficulties in taxing electronic services highlighted above could possibly be solved by using technological solutions. Lamensch proposes such a solution, based heavily on the Real Time VAT project (RTvat)<sup>121, 122</sup>.

RTvat originated as a means to combat VAT fraud in the EU.<sup>123</sup> As the name (real-time) indicates, the RTvat shifts the collection of VAT into real-time. Both the supplier's liability to remit the VAT to the tax authorities and the customer's right to deduct VAT arise at the time the transaction is paid for, not at the time of issue or receipt of any invoice. By using a technological solution, the financial institution through which the customer pays his supplier, automatically splits off the VAT element from the price and diverts it directly to the tax authorities.<sup>124</sup>

Thus, the solution Lamensch advocates shifts the burden of tax assessment and collection from suppliers to financial institutions. According to her proposal, the customer would, when conducting an online purchase, be redirected to a "secure payment area" where he identifies himself using credit card details, login, codes or similar. Hence, bank would be able to identify users with

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121 See [www.rtvat.eu](http://www.rtvat.eu)

122 Lamensch, M. *Unsuitable EU VAT Place of Supply Rules for Electronic Services – Proposal for an Alternative Approach* World Tax Journal February 2012. Page 88.

123 Ainsworth, R. *VAT Fraud as a Policy Stimulus – Is the US Watching? VAT Withholding, Rtvat, and the Mittler Model* 62 Tax Notes International 397 (May 2, 2011). Boston University School of Law Working Paper No. 11-08

124 Wohlfahrt, Beate: *The Future of the European VAT System*, International VAT Monitor November/December 2011 Page 394.



certainty, whether they are business or private customers and where their place of residence or establishment is located.<sup>125</sup>

The e-supplier would then communicate the retail net price to a bank, also through the secure payment area. The correct amount of VAT would then be calculated by a software program. Upon payment, the bank would only transfer the net price to the supplier. The VAT would be retained and wired to the correct tax authority in an automated way.<sup>126</sup>

The system has the advantage of relieving e-suppliers from their compliance burden as they no longer would have to conduct per-transaction identification verifications. Furthermore, everything is made in an automated way and the burden of the banks would be minimal as this model is based on already existent online payment schemes. The tax is paid at the moment of the transaction in a completely transparent way, reducing the risk for fraud. It also allows any kind of payment device to be used, as long as the payment is made electronically (online payment is a common feature of all electronic supplies). Finally, as the model is based on already existing structures, it could be implemented on a very short notice.<sup>127</sup>

The drawbacks include the fact that there would be some implementations costs. However, as much of system is already in place, these costs should be low. Some maintenances costs would, however, occur. Another drawback is that the system requires compliant e-suppliers. It would be possible to circumvent the system by asking customers to wire the money in a conventional way. That is already possible today, however. This system at least makes it impossible for consumers to commit fraud without involving the e-supplier. Lastly, the prevalence of exemptions and preferential rates differing from one country to another may complicate things. A solution to that issue would be that e-suppliers divide their supplies into different categories when communicating the price of the transaction to the bank. Such information could also be pre-programmed in the software and be linked with rate information to calculate the correct tax. This does, however, require a certain degree of harmonisation in respect of categorising the supplies as well as the good faith of e-suppliers. However, the good faith of suppliers is also an issue for conventional

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125 Lamensch, M. *Unsuitable EU VAT Place of Supply Rules for Electronic Services – Proposal for an Alternative Approach* World Tax Journal February 2012. Page 89.

126 Ibid.

127 Ibid. Page 90.

transactions as supplier purposely could misqualify a supply in order to benefit from an exemption or a preferential rate.<sup>128</sup> Lastly, as the RTvat makes high demands on the technical payment infrastructure and the necessary cooperation between intermediate financial institutions and tax authorities, a system based on it could be perceived as less attractive to adopt.<sup>129</sup>

Interestingly, in respect of Lamensch's proposal, the RTvat organisation states that she has not entirely grasped the roll of banks in the collection process. The RTvat is proposing the implementing of a central server based “gateway” through which all electronic payments would flow. Even though banks would remain important partners in the collection process, they would not be the primary point at which due taxes are extracted. That would, rather, occur at the central server level, supervised by a trusted third party.<sup>130</sup> In any event, I don't think this affects the validity of Lamensch's proposal.

## 5.4 Summary

So, in this section a few alternative approaches to deal with electronic supplies have been discussed. To exclude electronic commerce from the scope of VAT would, admittedly, solve all the problems concerning enforcement and the compliance burden of e-suppliers. However, I do not think it is a feasible option due to the revenue losses it would result in. Additionally, it would be contrary to both neutrality and the aim of VAT to tax as broadly as possible to exclude it.

Likewise non-taxation of electronic commerce, an origin-based taxation of these transaction would resolve the issue with compliance burden. However, as this would essentially recreate the disadvantageous situation EU e-suppliers were in prior to the implementation of a VAT regime on electronic commerce, this alternative is not satisfying either.

The last alternative discussed is the technological solution proposed by Lamensch. This would shift the tax collection burden from suppliers to financial institutions and, thus, solving the issue of e-supplier's compliance burden. Even though it is not without flaws, I think that its automatic and instantaneous nature mirrors that of electronic supplies and therefore makes it a suitable

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128 Lamensch, M. *Unsuitable EU VAT Place of Supply Rules for Electronic Services – Proposal for an Alternative Approach* World Tax Journal February 2012. Page 90.

129 Wohlfahrt, Beate: *The Future of the European VAT System*, International VAT Monitor November/December 2011 Page 395.

130 <http://www.rtvat.eu/> accessed 2014-01-07

method. It solves the issues of identifying and locating the customer as long as payment is made by electronic means and the fact that is based on already existing structures makes it implementable on a short notice.

In the end of the day, I think that a technological solution, not necessarily the one mentioned above, will be the best way to tackle the challenge of taxing electronic commerce.

## 6 Conclusions

In this final section, I will summarise the answers to the questions set out as the purpose for this thesis.

First of all, what is electronic commerce? Broadly speaking, there are two main categories of electronic commerce, namely, the indirect electronic ordering of tangible goods, which must be physically delivered using traditional channels such as postal services or commercial couriers and direct online ordering, payment and delivery of intangible goods and services such as computer software, entertainment content or information services on a global scale. For EU VAT purposes it is the latter category that is defined as electronic services or electronically supplied services and subject to special treatment.

The EU VAT Directive, together with annexes and implementing regulations, has listed numerous transactions in detail which are deemed to constitute, and not constitute, electronic services for VAT purposes. Even though the list is very detailed and specified, it is explicitly stated that it is not exhaustive. By keeping the list indicative, the EU avoids it from being obsolete. In the end of the day, the criterion that renders an electronic services is that it is essentially automated and involving minimal human intervention, and impossible to ensure in the absence of information technology.

Second, what are the difficulties when taxing electronic commerce? Electronic commerce is global to its nature. Electronic services are available at any moment, almost instantaneously, unconstrained by time, space and borders and in an automated way. Online deals are concluded on an interactional basis and often anonymously. All these aspects make it difficult for a traditional VAT system to identify and locate the parties to the transaction and subsequently enforce the system.

Thirdly, how does the EU tax and, how will the EU tax electronic services?

Under the current regime, all electronic supplies but intra-community supplies to non-taxable persons are taxed at destination. Nevertheless, in order to prevent double taxation, non-taxation or distortion of competition, and in order to tax, when possible, where consumption actually occurs Member States may switch the place of supply to where it is “efficiently used and enjoyed”. It must be

noted, however, that this does not apply to electronically supplied services when rendered to non-taxable persons established outside the EU nor to electronic services supplied by non-EU e-suppliers to EU non-taxable persons. In order to facilitate the compliance burden for non-EU e-suppliers, who would otherwise have to register for VAT in every Member State in which they have customers, in respect of B2C transactions, these suppliers may opt for a special scheme under which they register for VAT in one “Member State of identification”. Accordingly, they will only have to comply with their VAT obligations in that Member State.

As of 1 January 2015, the above will change and all electronic will be taxed at destination. As a consequence of this, the special scheme will be extended to include also B2C supplies made by EU e-suppliers. The efficient-use-and-enjoyment clause will also be extended to include all electronic supplies.

The VAT Directive puts a significant compliance burden on the e-supplier under the destination principle as he is obliged to identify the status and locate customers on a per-transaction basis. It is indeed positive that attempts are made to increase clarity in this respect through the Implementing Regulations. However, criteria laid down there are rather complex and lack clarity so it is questionable if they will have any real effect. As regards the “effective-use-and-enjoyment”-criterion, it is doubtful if it will be implementable at all. In the end of the day, taxing electronic commerce at destination is not very feasible and the situation is likely to worsen as more services will be covered.

Fourth, are there any alternative methods? In this thesis, I have discussed three alternative methods to the one pursued by the EU.

The first method discussed was to tax electronic commerce where the supplier is established. This would arguably solve the compliance issue of the e-supplier having to identify and locate his customer in a digital context. However, under such a regime an EU e-supplier would be taxed on all his supplies, whether to EU customers or to non-EU customers, while the supplies of non-EU e-suppliers would be VAT-free. This would create a competitive disadvantage for EU e-supplier which is not desirable and, hence, this method is not feasible.

The second method was to not tax electronic commerce at all. By all means this would solve all compliance and enforcement issues. However, this would come at the cost of revenue losses and would be contrary to neutrality and the aim of

VAT to tax as broadly as possible. Consequently, this alternative is not viable either.

The third alternative was a technological solution, based on RTvat. Although not completely without flaws, it would solve the most compliance and enforcement issues, it would tax the transactions in an automatic and per-transaction basis, and it would be based on already existing structures, making it viable to implement on a short notice.

To conclude, I believe that a technological solution will be the most feasible option when taxing electronic commerce. It does not necessarily have to be the one discussed in this thesis even though it has its advantages.

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