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*Electronic Services and VAT Jurisdiction Rules in the European Union**

Usługi elektroniczne a jurysdykcja w zakresie VAT w Unii Europejskiej

Keywords: VAT; tax jurisdiction; origin principle; destination principle; electronic services

Słowa kluczowe: VAT; jurysdykcja podatkowa; zasada pochodzenia; zasada przeznaczenia, usługi elektroniczne

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Introduction

Tax principles were historically designed to govern economic activity that dealt with the production and sale of tangible manufactured goods. For cross-border transactions, rules were developed to assign a tax jurisdiction to a specific geographic space [Cockfield, 2002, p. 608]. The purpose of a VAT is to impose a broad-based tax on consumption, which is understood to mean final consumption by households. In principle only private individuals, as distinguished from businesses, engage in the consumption at which a VAT is targeted. In practice, however, many VAT-systems impose a VAT burden not only on consumption by private individuals, but also on various entities that are involved in non-business activities [OECD, 2014, p. 6]. Next, taxpayers are entitled to deduct the input tax on purchases and account for the output

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tax on sales. Each business in the supply chain takes part in the process of controlling and collecting the tax by paying the difference between the VAT that is paid out to its suppliers and the VAT charged to its customers [Kogels, 2006, p. 375].

1. VAT jurisdiction – origin principle vs. destination principle

Tax jurisdiction is defined as an internally and externally unlimited sovereignty of a state, which manifests itself in relation to other states in exercising exclusive authority in respect to acts of legislation, administration, and justice authority within its territorial power sphere. Tax jurisdiction is a consequence of state's territorial autonomy, which means domination over the persons and objects within its territory [Knechtle, 1976, p. 34].

Hellerstein distinguishes two inquiries of tax jurisdiction: substantive jurisdiction and enforcement jurisdiction. A state has enforcement jurisdiction in relation to a particular tax when it has practical and effective instruments of collecting the tax – i.e. the country has power over a person or some assets from which the tax can be collected. Substantive jurisdiction, in turn, relates to a state's justification to impose taxes – exclusive tax sovereignty should guarantee a state the right to levy taxes with no limits, but in practice there are limitations on sovereignty that require a "link" between the subject matter being taxed and the state imposing the tax [Hellerstein, 2003, p. 3–8; Millar, 2009, p. 276].

With regard to VAT, jurisdiction is based on the destination principle (place of consumption) or origin principle (place of supply). An origin-based tax applies to the added value originating in the taxing jurisdiction, that is, to domestic production; it applies to exports. A destination-based tax applies to the consumption occurring in the taxing jurisdiction; it applies to imports [McLure, 2003, p. 147]. The result of applying the origin principle is that the tax burden on goods or services supplied to private consumption equals the sum of the value added in each country that contributed to the production, distribution, and supply of the goods or services, multiplied by the VAT rate applicable in each such state. The consequence of applying the destination principle is that the tax burden on goods or services supplied for private consumption is determined by the VAT rate applicable in the country of destination (consumption), and all of the tax revenue in relation to those goods or services accrues to that state [Millar, 2009, p. 287].

Under the origin-based VAT, exports bear tax on the value that is added within the taxing jurisdiction; it is essential that the full value of exported goods (rendered services) bear the domestic tax, and that full credit for the value of import is granted [Schenk, Oldman, 2007, p. 183].

In most countries where the destination principle is used, the VAT on cross-border B2B supplies of services and intangibles is usually collected by the reverse charge mechanism. This is a tax mechanism that switches the liability to pay the tax from the supplier

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to the customer; in the absence of such a mechanism, foreign suppliers that deliver services in countries where they are not established would in principle have to register for VAT purposes and fulfill all VAT obligations in that country [OECD, 2014, p. 8].

2. Place of supply and VAT jurisdiction in the European Union

Most tax systems include rules to specify their jurisdictional range. Such rules determine whether the required link exists between the country whose law is being applied and the subject matter of the tax – in VAT systems these rules are commonly referred to as "place of supply" rules [Millar, 2008, p. 176].

When the common value added tax system was introduced in Europe in the period between 1968 and 1973, the purpose of VAT was to ensure tax neutrality on intra-Community trade. According to the then-applicable Second Council Directive 67/228/EEC of April 11, 1967 (Second VAT Directive), the place of supply was where the service was rendered, a right granted or a good used. However, each Member State had some flexibility in order to determine its own rules for the place of supply. For example, the following criteria were applied [Amand, 2003, p. 267]:

- place of effective use – in France,
- place of effective use and place of establishment of the supplier – in Belgium,
- place of material performance and of establishment of the customer – in Germany and Ireland.

Since the lack of harmonized rules under the Second VAT Directive gave rise to conflicts concerning jurisdiction between the Member States, more detailed rules on the place of supply of services were laid down by the Directive 77/388/EEC of May 17, 1977 (Sixth VAT Directive) that succeeded the Second VAT Directive. Under art. 9 of the original text of the Sixth VAT Directive, the main rule was that services were deemed to be rendered at the place where the service provider had established its business (under the origin principle) [Swinkels, 2006, p. 101].

Directive 2006/112/EC of November 28, 2006 (EU VAT Directive), which replaced the Sixth VAT Directive as of January 1, 2007, defines, as a general rule, the place of supply of services as either the place where the supplier has established its business or has a fixed establishment from which the service is supplied, or, in the absence of such a place of business or fixed establishment, the place where it has its permanent address or usual residence (art. 43 of EU VAT Directive). On February 12, 2008, Directive 2008/8/EC was adopted; it changed the place of supply services and implemented two new general rules, one for taxable persons based on the destination principle, and one for non-taxable persons based on the origin principle (articles 44 and 45 of EU VAT Directive). According to article 44 of the EU VAT Directive, the place of supply of services to a taxable person acting as such shall be the place where that person has established his or her business. Article 45 of the VAT Directive provides that the place of supply of services to a non-taxable person shall be the place

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where the supplier has established its business. In this scheme, Brederode suggests that non-taxable consumers who are registered for VAT and customers who make both taxable and nontaxable sales should be considered as taxable persons for the purpose of the VAT jurisdictional rules [Brederode, 2009, p. 230].

On top of general rules to determine the place of supply of services, the VAT Directive provides many particular regulations. For example: a) the place of supply of services rendered to a non-taxable person by an intermediary acting in the name and on behalf of another person shall be the place where the underlying transaction is supplied, b) the place of supply of the intra-Community transport of goods to nontaxable persons shall be the place of departure.

Generally then, in the case of B2B supplies (where the destination principle applies without exception), tax assessment and collection obligations are shifted to the business customer under the reverse charge mechanism, which actually applies to all cross-border supplies of services to taxable persons. The place of supply of services to non-taxable persons is, as a main rule, the place where a supplier has established its business or has a fixed establishment from which the service is supplied [Terra, Kajus, 2010, p. 510]. But in the case of B2C supplies – the destination (rather than the origin) principle applies, then the reverse charge mechanism cannot be applied, because consumers are not registered taxpayers and have no possibility to voluntarily proceed to the remittance of the tax. They have to bear the economic burden of the tax without any possibility of recovering it [Lamensch, 2012, p. 2–3].

3. Electronic Services and "place of supply" rules in the EU

The concept of electronic services is defined in Article 7 of the Council implementing regulation (EU) 282/2011 of March 15, 2011 (Regulation 282/2011). This article also includes examples of services that qualify as electronic services and those that do not. Electronically-supplied services (as referred to in the EU VAT Directive) shall include services that are delivered over the Internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention, and impossible to ensure in the absence of information technology. It shall cover, in particular:

- the supply of digitized products generally, including software and changes to or upgrades of software,
- services providing or supporting a business or personal presence on an electronic network such as a website or a webpage,
- services automatically generated from a computer via the Internet or an electronic network, in response to specific data input by the recipient.

The following examples are not treated as electronically-supplied services[1]:

[1] The full list is enclosed in art. 7 § 2 of Regulation 282/2011.

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- broadcasting services,
- telecommunications services,
- goods, for which the order and processing is done electronically.

On January 1, 2015, EU VAT Directive was amended with the addition of a new particular jurisdictional rule related to electronic services. This addition states that the place of supply of the electronically supplied services to a non-taxable person shall be the place where that person is established, has a permanent address or usually resides. Communication between the supplier of a service and the customer via electronic mail shall not itself mean that the service supplied is an electronically supplied service[2].

In line with the EU VAT system, most B2C supplies of services are taxable at the place of the supplier (the origin principle); however, as of January 1, 2015, all electronic services are taxable at the place where the customer belongs, even if the customer is a non-taxable person. The main change is a shift from the origin principle to destination principle as the main principle of the place of supply of electronic services for B2C transactions. For B2B transactions, the customer will still be able to account for any tax due through the reverse charge mechanism. As Lamensch concludes, the reverse charge mechanism reduces suppliers' compliance costs by shifting the liability to assess and remit the amount of tax to business customers, who are registered for VAT purposes and comply with their tax obligations on a self-assessment basis via their periodic returns. It also reduces administrative costs for the tax administrations that do not have to monitor a large number of registrations for a limited number of taxable supplies on their territory [Lamensch, 2012, p. 3]. However, in a B2C supply transaction, proceeding to the remittance of the tax is not possible. As a consequence, the liability to account for any VAT due in a member state will rest entirely with the supplier registered in another jurisdiction. Therefore, in order to relieve businesses of the obligation to register for VAT purposes in every member state in which they supply such services to non-taxable persons, the new legislation provides that taxable persons can make use of a special scheme allowing them to be identified for VAT purposes in one member state only instead of having to register in every member state of consumption. This is the so-called Mini One Stop Shop – MOSS [European Commission, 2014, p. 6].

The system is optional, and is a simplification measure following the change to the VAT place of supply rules, in that the act of supplying takes place in the member state of the customer, and not in the member state of the supplier. Under this scheme, a VAT taxpayer that is registered for the MOSS in a member state (the member state of identification) electronically submits quarterly MOSS VAT returns detailing the delivery of electronically supplied services to non-taxable persons in other member states (the member state(s) of consumption), along with the VAT due. These returns, along with the VAT paid, are then transmitted by the member state of identification to the corresponding member states of consumption via a secure communication

[2] See art. 58 of VAT Directive.

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network. The MOSS VAT returns are an addition to the VAT returns that a taxable person renders to its member state under its domestic VAT obligations, and are applicable to taxable persons which are established in the EU (so-called the Union scheme), as well as taxable persons that are not established within the EU (so-called the non-Union scheme) [European Commission, 2013, p. 2].

Because of the new jurisdictional approach of the MOSS system, the European Commission decided to clarify some crucial definitions, such as the definition of a "taxable person" in relation to the new system, the concept of "the member state of identification" and "the concept of the member state of consumption".

Under the Union scheme, a taxable person is a business (company, a partnership or a sole entrepreneur) that has established its business or has a fixed establishment in the territory of the EU. Next, the member state of identification is the state in which the taxable person is registered for using MOSS, and where it declares and pays the VAT due in the member state(s) of consumption. The member state of consumption is the state in which the taxable person delivers electronically supplied services to non-taxable persons [European Commission, 2013, p. 3–4].

Within the legal and administrative aspects of the new MOSS system, one of the crucial issues is the "scheme of presumptions" anchored in the provisions of Regulation 282/2011, related to the location the customer [Rudzka, Zieliński, 2014, p. 29]. According to art. 24a of Regulation 282/2011, when a supplier of electronically-supplied services provides those services at a location, such as a telephone box, a telephone kiosk, a Wi-Fi hot spot, an internet café, a restaurant or a hotel lobby, where the physical presence of the recipient of the service at that location is needed for the service to be provided to him by that supplier, it shall be presumed that the customer is established, has his permanent address or usually resides at the place of that location, and that the service is effectively used and enjoyed there. By contrast, when electronically-supplied services are supplied to a non-taxable person through[3]:

- his or her fixed land line – it shall be presumed that the customer is established, has his or her permanent address or usually resides at the place of installation of the fixed land line,
- mobile networks – it shall be presumed that the place where the customer is established, has his or her permanent address or usually resides is the country identified by the mobile country code of the SIM card used when receiving those services.

The above-mentioned basic rules of determining the place of supply of electronic services create a new legal and financial framework for e-businesses in the EU. However, while there is a positive impact from the new VAT jurisdictional rules on European electronic commerce, it is worth to point out the potential problems. Implementing a special rule charging VAT on digital services based on the destination principle can generate additional administrative burdens for taxpayers (suppliers).

[3] See art. 24b of Regulation 282/2011.

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This is because VAT rates within member states vary between 3% and 27%. For electronic suppliers that will not choose the MOSS system, the EU VAT Directive requires enterprises to correctly determine the location of their customers, as well as their VAT status, in order to establish the actual tax rate that is applicable. As a consequence, sellers will have to gather "two pieces of non-contradictory information that could be used as evidence confirming the location of the customer" [Enterprise Notion, 2015, p. 6]. Another potential problem is that suppliers must always pay VAT upon submission of their returns, as no credit is available under that procedure. Therefore, suppliers using MOSS will have to "in all cases recover any refundable input VAT from each state where it was paid, and may not benefit from the traditional EU invoice credit mechanism" [Lamensch, 2012, p. 7].

Conclusion

The EU common system of value added tax includes rules to specify the jurisdictional reach of each member state. These rules are referred to as "place of supply" rules and determine whether the requisite connection exists between the country the VAT law and the subject matter of the VAT of which is being applied. From a theoretical point of view, the jurisdictional reach of VAT can generally be based on the destination principle or on the origin principle. These two principles reflect fundamentally different approaches. The destination principle focuses on the place where consumer is located, while the origin principle places its attention on the location where supplier has its residence.

From January 1, 2015, all deliveries of electronic services are taxable at the place where the customer belongs (the destination principle). In order to ensure the correct taxation of these services, EU and non-EU businesses will need to determine the tax status of their customers and the country of the EU or outside the EU where that customer belongs. To reduce potential administrative costs of new digital VAT rules, European legislators decided to allow electronic suppliers to choose special administrative scheme to calculate and pay tax, known as the mini One Stop Shop.

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Usługi elektroniczne a jurysdykcja w zakresie VAT w Unii Europejskiej

Od 1 stycznia 2015 r. usługi świadczone elektronicznie w UE podlegają opodatkowaniu w państwie, w którym konsument ma miejsce zamieszkania (siedzibę), bez względu na to, czy jest zarejestrowany jako podatnik VAT. Kluczowa z wprowadzonych zmian to odejście od zasady pochodzenia na rzecz zasady przeznaczenia jako kryterium ustalania miejsca świadczenia usług elektronicznych w odniesieniu do transakcji B2C w UE. Z kolei nowym mechanizmem jest „Mały punkt kompleksowej obsługi", za pośrednictwem którego przedsiębiorcy mogą dokonywać rozliczeń VAT, stosując stawki podatkowe obowiązujące w innych państwach członkowskich niż państwo, w którym mają siedzibę. Celem artykułu jest analiza prawnych i ekonomicznych aspektów tych zmian.

Electronic Services and VAT Jurisdiction Rules in the European Union

From January 1, 2015 electronically delivered services in the EU are taxed in the country where the customer resides, regardless of whether the customer is a VAT payer or a consumer. The main change involves a shift from the origin principle to destination principle as the criterion for determining the place where electronic services for B2C transactions in the EU are provided. The Mini One-Stop Shop is a new mechanism through which businesses can account for VAT at the rates applicable in member states other than where they are established. The purpose of this article is to analyze legal and economic aspects of these changes.