Tax Representation

Tax Faculty

TAXREP 17/05

VAT – PLACE OF SUPPLY OF SERVICES TO NON-TAXABLE PERSONS

Memorandum submitted in April 2005 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to an invitation to comment issued in February 2005 by the European Commission.

CONTENTS

VAT – PLACE OF SUPPLY OF SERVICES TO NON-TAXABLE PERSONS

INTRODUCTION

1. We welcome the opportunity to comment on the consultation document entitled "VAT – The Place of Supply of Services to Non-Taxable Persons" published on 2 February 2005 by the European Commission at

http://europa.eu.int/comm/taxation_customs/resources/documents/vat_place_of_supply_en.pdf

KEY POINT SUMMARY

2. Our main comments are:

i. We welcome progress towards the creation of a true single market that closely resembles an internal market but we are disappointed with the slow rate of progress. The creation of a true single market has been a goal of the EU since it was founded and its achievement will boost economic activity. If encouraging economic growth is a key objective of member states we suggest that action towards creating a true single market should be given high priority.

ii. Small and medium sized enterprises (SMEs) in the UK are the main group disadvantaged by the failure of the EU to provide a practical VAT system that facilitates cross border commerce. UK SMEs have language and geographical barriers to cope with as well as the burden of VAT administration. We think they are entitled to know what factors are obstructing more rapid progress towards the development of an effective VAT system in Europe.

iii. We recognise the difficulties of obtaining unanimous agreement of all member states which is a prerequisite of progress on tax matters. The gradual approach of the Commission of proposing only those changes likely to meet with the support of the Council may well be the right one but it needs to be reviewed regularly in case a way of providing more rapid progress can be found.

iv. We would like to see more progress on the one-stop system which is a concept we support. However, it should be a one-stop system that is user friendly and is designed to minimise the compliance burden. Accordingly, VAT returns should be in the language of the country of registration and the taxable person should be required to make a single payment of his EU VAT liabilities. Ultimately we would like to see the option of single VAT registration available to all EU traders.

v. We do not think it is absolutely essential for VAT rates and the rules for input tax deduction to be brought into line throughout the EU in order to introduce single EU VAT registration although some harmonisation is desirable on grounds of simplicity among other reasons.

vi. The time-limited special scheme for the supply of electronically delivered services by non-EU suppliers should be terminated as soon as possible and be subsumed in a one-stop system.

vii. We note that the changes now proposed by the Commission will still not achieve a system that provides for tax at the place of consumption. There is now general acceptance of the principle that VAT should accrue to the country of consumption. We think that member states will eventually require a system that incorporates this principle.

viii. With this principle in mind we favour changing the general rule for the place of supply of services to the place where the customer usually resides. We understand that special rules will be needed to simplify identification of the place where the customer belongs and to deal with the special schemes in Article 24. (References to articles are Articles of the Sixth VAT Directive.) Also we are aware that such a change cannot be contemplated without the introduction of the one-stop system.

ix. Our final general comment is that we are concerned that the legislative process in the EU does not work well and is in need of review and possibly reform. The need for unanimity causes many of the problems that result in protracted negotiations between member states, unsuitable legislation and little progress. We have considered carefully what we would regard as the requirements of a good tax system and we attach in the Annex our Ten Tenets for a Better Tax System. Also the EU legislative process is not sufficiently transparent. Sometimes the legislation finally adopted is markedly different from the proposal originally submitted by the Commission. Draft legislation in its final form should be made available by the Commission to the public with explanatory notes before member states commit themselves to the adoption of the legislation. That is just one suggestion for change; our main recommendation on this matter is that, following the recent expansion of the EU, there should be a review of the EU legislative process.

WHO WE ARE

3. The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

4. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.

5. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.

GENERAL COMMENTS

6. We are disappointed with the lack of momentum towards the creation of a single market that is exactly similar to an internal market such as, for example the market between England and Wales. (We are not referring to the transitional system here which mainly relates to goods and is often referred to as the "Single Market." Clearly at present we do not have a single market that resembles an internal market.)

7. In general we support the moves made by the Commission recently but we would prefer to see more rapid progress. We appreciate, however, that progress is largely dictated by political considerations and attitudes in member states and that reconciling these interests is the reason why progress is not more rapid. However, the cost of the delay in introducing a practical system of VAT that facilitates cross border commerce is borne in the UK mainly by SMEs. The existing VAT system is so onerous for traders who operate across EU national borders that it is a serious impediment to trade. It is not clear to businesses and interested parties in the UK why more rapid progress cannot be made towards a system that actually works. The traders who are paying the penalty for the lack of progress are entitled to know what is preventing a faster pace.

8. We think that the strategy of only putting forward those matters on which agreement of the member states is likely to be obtained will at least result in some progress being made. However, this needs to be kept under review because, as noted above, progress is very slow. Furthermore, the lack of progress gives a misleading impression that the Commission is doing very little to further the goals of the Community.

9. The temporary special scheme for electronically supplied services in Article 26C(B), which expires on 30th June 2006, is an unsatisfactory tax system. It is a messy compromise that has resulted from a legislative process which has protracted negotiations as its trade mark. The special scheme is discriminatory, unfair, impractical and deeply flawed. It should be terminated without delay. In the UK only 165 traders have registered under the scheme and if any of them incur input tax in the UK they will be unfairly treated by the scheme. They are also subject to unfair competition from EU traders who set up in member states with low tax rates. We think that the special scheme should be subsumed in a one-stop system forthwith.

10. Fortunately, the special scheme for electronically delivered services by non-EU suppliers is a time-limited provision. The only redeeming feature of the special scheme is the reallocation of revenue to member states of consumption. We think that this should be a central feature of the one-stop system. It has been suggested that it may be necessary to reinforce such a measure with some form of penalties to compel member states to pass to other member states the right amount of tax at the right time. However, we recognise that such a provision is unlikely to obtain the unanimous support of member states. This is perhaps why some favour a scheme of tax payment using trusted intermediaries. But it would be an unnecessary burden on traders and would seriously undermine the system. In order to ensure that the scheme is very widely used by traders, the one-stop system must be simple and user friendly.

11. We are in favour of the one-stop system which was the subject of an earlier consultation. We submitted our comments to you in July 2004 as TAXREP 31/04 (http://www.icaew.co.uk/viewer/index.cfm?AUB=TB2I_67695). Clearly the one-stop system is preferable to multiple registrations for SMEs. We think it is not onerous for the trader to provide a breakdown of his turnover by country and similarly a breakdown of his input claims by country. If this in effect means separate returns for each country and a consolidated return we think that is preferable to multiple registrations. The trader ought to be able to deal with just one tax authority in his own language.

12. There is a typographical error in paragraph 11 of our tax representation on the One-Stop System. What it should have said is **"What we would like to see** at the heart of the proposal is a system for settling tax indebtedness between member states." (The emboldened words were omitted.) The system we have in mind is the one that first appeared in the special scheme for non-EU suppliers of electronic services as mentioned above. It is not a clearing system and it does not involve the Commission in its operation. However, we recognise that the one-stop system proposed by the Commission did not enable the taxable person to make a single payment of his EU VAT liabilities to the country of registration. We are disappointed that the member states do not appear to be in favour of a system which allows the trader to make a single payment of his total EU tax liability and then requires the tax authority of registration to be responsible for allocating the tax to other member states. This is hardly onerous for the tax authority bearing in mind that much more is expected of the taxpayer when he is acting as unpaid tax collector. The impression being given is that the tax authorities are not prepared to assist the trader to hand over the tax collected in the easiest possible way.

13. Another disappointing development is that member states are apparently not prepared to agree to deal with input tax repayment claims in an efficient way. Under the one-stop system it should be possible to deal with net VAT repayments in the same way and at the same time as VAT payments. There is no justification for carrying forward input tax claims where there is a net repayment due unless there are reasons to investigate the claims.

14. We do not think it is essential to harmonise VAT rates or the rules for input tax deductions in order to introduce a system of single EU VAT registration. Nevertheless some harmonisation of the input tax rules would make it easier for traders to fulfil their tax responsibilities. Most traders supplying goods or services in another member state would not be surprised if they are told that the rules are being revised so that they must apply the VAT rates of the country in which the supplies are made. They will, however, be concerned about their compliance obligations and we say more on that below.

15. The Commission suggests the general rule for the place of supply of services should continue to be the place where the supplier is established. The Commission goes on to say that this will lead to taxation at the place where actual consumption takes place in most cases. This may be the case at present but we question whether it will be the case in the future and whether retention of the rule is justified. Furthermore, it is not

clear whether obtaining the correct result in "most cases" is accurate enough at present let alone in the future. The EU needs to increase cross border trade in order to foster economic growth. Indeed, if this does not happen, it calls into question the fundamental basis upon which the EU is founded. If cross border activity increases, as envisaged, there will be a growing number of supplies where the present general rule does not result in taxation at the place of consumption.

16. We also agree with the Commission's comment that changing the general rule to taxation where the customer is established or usually resides would only be feasible once the one-stop system is in place. Since we think an optional one-stop system should be introduced as soon as possible we do not see it as a drawback.

17. A further issue identified by the Commission is the difficulty of determining the place where the customer usually resides. We think more work should be done on producing a practical system for determining usual residence. The place where the service is actually consumed should be one of the factors to be considered in framing such a system.

18. One further obstacle to the change of the general rule to the place where the customer usually resides is Article 24 which provides special schemes for small undertakings. A trader who supplies services in a member state other than the one where he is registered will be unable to take advantage of the exemption under Article 24. This would not deter most traders for whom the one-stop system would be an attractive option. Another possibility is to use total EU turnover to determine VAT registration thresholds.

19. While we recognise that there are some problems which need to be addressed, we think that the general rule should be changed to the place where the customer usually resides.

DETAILED COMMENTS ON THE SPECIFIC RULES

20. **Immovable property.** The place of supply under the existing rules is the place where the property is situated and not (if different) the place where the services are carried out. The same applies whether the supply is a B2B supply or a B2C supply. The Commission proposes to retain this rule and we agree.

21. **Passenger transport.** We agree with the Commission's proposal to change the treatment of passenger transport to the place of departure and we also agree that B2B and B2C supplies of passenger transport should have the same place of supply rules. We can see the practical difficulties of taxing passenger transport by reference to where the transport takes place and to the distance covered. We also agree with the Commission's proposals for taxation at the first place of entry to the Community in the case of international land and sea transport.

22. **Intra-Community transport of goods.** We agree entirely with the Commission's comments on this topic. Clearly the present system is burdensome for traders who have to account for VAT in each member state in which the removal of the goods begins. Small transport operators must find it very difficult to cope with. We agree

with the Commission that the present rule should be maintained and we also agree that the compliance burden could be eased using the one-stop mechanism.

23. **Restaurant and catering services.** In general we agree that the place of supply rules for B2C supplies should be the same as B2B supplies if possible. Furthermore it makes sense to treat such services as supplied where they are physically carried out. In the case of restaurant and catering services supplied on board ships and trains it may be possible to apply the same treatment as the passenger transport. In other words to tax the supplies at the place of departure in cases where, first, the transport takes place entirely within the Community and second, where the journey starts and ends in the Community. This might provide a fairer allocation of revenues than relying on where the trader is established. Also it will discourage those who would otherwise set up in a low tax country. Furthermore, it will probably result in a fairer treatment of the customer and should not be too onerous for the trader**.**

24. **Hiring of means of transport.** We agree that the place of supply of the service of short term hire of means of transport should be the place where the means of transport is made available to the customer. We also agree that it is logical to treat B2C supplies in the same way as B2B supplies. We have no comments on the treatment of long term leasing.

25. **Exhibitions, fairs, cultural events, valuation of and work on tangible movable property.** Article 9 (c) covers a wide variety of services and we can see a number of problems with the present place of supply rules. Nevertheless it is probably advisable to retain the present rule that the services be deemed to be provided where they are physically carried out. Again we agree with the Commission that the one-stop mechanism should avoid high administrative burdens for suppliers.

26. **Article 9 (2) (e) services which can be supplied at a distance.** We are not at all surprised that traders are setting up in low rate member states in order to exploit the flaws in the treatment of electronically supplied services. As stated above we think that the present arrangements for dealing with electronically delivered services should be changed. We agree that the place of supply should be the place where the customer who receives the service is located. Whether this should be the place where the customer usually resides is a matter for further consideration. A practical means for determining the place where the services are received must be found. The taxation of financial services gives rise to a number of special considerations and is better left to a separate study as the Commission suggests. With regard to the compliance obligations of traders affected by the Commission's proposal for change in relation to these services we again agree that the one-stop mechanism would help and in our view would be of assistance to the trader and tax authorities alike.

27. **Services supplied at a distance –example.** An example of the difficulties with compliance obligations might add some clarification. A software supplier with a substantial turnover is established in Ireland and supplies software throughout the EU. At present his supplies to final consumers in all member states are treated as supplied in Ireland where he is established. He charges Irish VAT to all his EU customers and accounts to the Irish tax authorities for all the VAT collected. None of the tax attributable to supplies to customers outside Ireland is handed over to the country of

consumption. The Irish supplier may be noticing increased competition from low tax areas such as Madeira. If the situation persists the Irish supplier may have to set up in Madeira in order to compete on a level playing field. The distortions beginning to appear will multiply if nothing is done.

28. If the place of supply is changed to the country where the customer belongs as the Commission suggests the supplier will have to register in all member states in which he supplies software. He must also apply the tax rates ruling in the country of his customer. Clearly in the absence of the one-stop system a considerable burden will be placed on him. If he incurs input tax in other member states his problems will be exacerbated because he will find that the input tax deduction rules are not the same in all member states. But it is right that he should be required to charge French VAT if he is doing business in France and it is right that the tax should be accounted for to the French tax authorities. Furthermore, why should a customer in another EU member state be charged VAT at Irish rates – especially if the customer lives in a country where the tax rate is lower? We think that what the Commission recommends is correct but there will be some protests nevertheless. The rule should be changed in the way the Commission suggests. However, we stress that the tax authorities owe a duty to traders to make the task of complying with tax obligations as simple and easy as possible. In this situation and elsewhere we think the one-stop system is essential. Furthermore the duty to keep tax obligations simple and easy should be borne in mind in the design of the one-stop system.

29. **Intermediary services.** The Commission proposes that the place of supply should be changed from the place where the principal transaction is taxable to the place where the intermediary is established. At first sight this is a welcome simplification but we wonder whether this means that a principal supply which takes place outside the EU will result in the intermediary having to charge VAT on his services. Similarly if the intermediary's services are exempt there will no longer be a right of deduction for input tax. If both points are correct it will put the intermediary in a competitive disadvantage compared with intermediaries belonging outside the EU.

30. **Third country established suppliers and recipients.** We agree that Article 9(2)(e) services supplied to non-EU customers should be treated as supplied outside the EU and we also agree that the present rule should be kept. However, we see a case for the review of Article 9(2)(e) services when supplied by non-EU traders to EU final consumers. At present only electronically delivered services are taxable.

31. **Anti-avoidance provision of Article 9(3).** We note that the Commission proposes to maintain this provision. Potentially the provision could be used to reduce unfair competition from outside the Community.

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ANNEX

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory**: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. **Certain**: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. **Simple**: the tax rules should aim to be simple, understandable and clear in their objectives.

4. **Easy to collect and to calculate**: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. **Properly targeted**: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. **Constant**: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. **Subject to proper consultation**: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. **Regularly reviewed**: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. **Fair and reasonable**: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. **Competitive**: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99; see http://www.icaew.co.uk/taxfac/index.cfm?AUB=TB2I_43160,MNXI_43160.