EUROPEAN TELECOMMUNICATIONS NETWORK OPERATORS' ASSOCIATION

March 2005

ETNO Reflection Document on EC consultation: VAT – The place of supply of services to non-taxable persons

Executive Summary:

The EU Commission has in 2004 made proposals for the place of supply rules for VAT purposes to be amended for B2B transactions, and has recently made similar proposals for B2C transactions. The B2B changes are generally seen as positive whereas, whilst the reasons for the B2C changes are understood, they are for ETNO less welcome because these will bring increased costs and difficulties of compliance.

ETNO has difficulty agreeing to the proposals for two reasons: (1) Firstly the higher VAT rated countries generally welcome the sort of change proposed whereas the lower VAT rated countries do not. (2) Secondly, suppliers of B2C services would have to identify where their customers belong and charge VAT according. Suppliers would thus have to charge VAT at 25 or more rates if they provide services to consumers in all EU countries. In addition to that, although collection is in one member state (for onward distribution to member states of consumption), suppliers have to have regard to the particular VAT rules in all member states to be compliant. Hence the proposals are seen as being unduly onerous.

The European Telecommunications Network Operators Association (hereafter "ETNO") welcomes the opportunity to present its contributions concerning the Consultation Paper entitled "VAT – Place of Supply of Services to Non-Taxable Persons" recently issued by the European Commission.

ETNO represents 42 major telecommunication companies throughout Europe and in all EU Member States, providing a number of different services from traditional fixed line telecommunication services to mobile telecommunications, content provision and internet services.

ETNO generally supports the desire of the Commission to reduce distortion in the B2C market, but notes that principal reason for the distortion centres on the lack of harmonized VAT rates throughout the EU. We therefore have some concerns over whether it is right for it to be incumbent upon suppliers to account for VAT according to where the services are consumed, particularly as we feel that the practical effects of some of the Commission's proposals will prove to be unduly onerous to implement. The Commission has asked for comments to specific questions, and we detail our responses to those questions below.

- *Do you have other problems that have not been identified and which would need to be taken into account when amending Article 9 insofar as B2C services are concerned?*

Any amendment that results in the place of supply being determined by either a use or enjoyment basis or one based on the place where a customer is established, would cause significant administrative burdens to our members. These would only be slightly relieved by the One Stop Shop proposals. There would necessarily be major – and expensive -changes to billing operations unless concessionary relief were brought in to avoid the need to issue tax invoices to final consumers. We already have real issues over which jurisdiction has precedence for billing purposes. For example, a supplier based in the UK may issue a tax invoice according to the UK's rules, but may be issuing the invoice to his customer in France. Is he correct to use the UK rules? If not, the actual requirement of every country would need to be incorporated into the supplier's billing system, which would be unduly burdensome.

In addition there would be pricing issues which would present significant problems. B2C prices are usually quoted on a gross of VAT basis because VAT is not relevant to the customer. Any use and enjoyment or place of customer belonging rule would mean that our entire pricing systems would need to be reviewed and potentially altered to make sure that the correct amounts of VAT are being accounted for and the charge to the customer covers the appropriate amount of VAT that needs to be declared. Fairly sophisticated systems would need to be in place to ensure that our members know exactly where our customers are established, as a billing address cannot guarantee that this is the same as an establishment address (in addition, many customers would only get an e-bill). A supplier may normally charge the standard rate of VAT on his product but this may be subject to a reduced rate in the customer's country, in which case the supplier would have to code in more than the 25 rates presently thought to be necessary.

- *Do you agree to maintain the current general rule, which is taxation at the place where the supplier is established, or would you prefer a different general rule and if so, which general rule might this be – place where customer is established, place of actual use and enjoyment or an alternative?*

For the reasons given below ETNO members believe that the current rule for these services which can be supplied at a distance (i.e. taxation at the place where the supplier is established) should remain in place for the time being.

We are of the opinion that introducing a rule based on actual use and enjoyment would be unworkable for our members especially the mobile telecommunications companies. A mobile phone customer can "roam" (i.e. use their mobile phone in a country other than the country where they are based and hold their account). This would mean that if a "use and enjoyment rule" is introduced each mobile phone company would potentially have to account for VAT at the rate of each Member State in which the customer roams. Even if the one-stop mechanism is introduced this would create considerable administrative problems including changes to billing systems, invoicing details and pricing as the customer will be charged different VAT rates on the same monthly bill. This assumes one consolidated bill would be acceptable to each of the member states where VAT is due.

In addition introducing such a use and enjoyment rule would cause an issue with regard to the treatment of the same services supplied to business customers who may be using their mobile phone for business purposes in a country other than that in which they are established. As it will not be known at the time the call is made whether the customer is using that phone for business purposes then this could lead to the possibility of double taxation. Under the use and enjoyment rule VAT would be due in the Member State where the customer is roaming and under the business to business rule VAT would be due where the customer is established. Subsequent adjustment would be required to correct the issue. In addition it is likely that Member States would require evidence that roamers are using their phones for business purposes and that VAT is correctly being accounted for. This would cause considerable issues for international operators.

With regard to place of establishment of the customer it should be noted that the majority of customers will be established in the same country as the telephone service provider. However there are instances where mobile phone customers are resident in one EU Member state but have an account with a mobile provider in another country. For example a German citizen may live on the border with France and work in France. The customer will have an account with a French mobile phone company (as they spend their working time there). At present the French mobile phone company will account for French TVA on services provided. However, under the proposed rule the French Mobile phone company would have to account for German VAT on the services provided (as the customer is resident in Germany) which would create an administrative burden on the supplier who has to account for VAT in the second country (either by registering or using the proposed one-stop mechanism). The place of consumption of the services is France, the supplier is based in France, the

customer uses their phone in France but German VAT would be charged on the supply. This would seem to be contrary to the principle that tax should accrue to the country of consumption (which is what the present rules largely achieve).

What would Telco suppliers be required to do if they supply the same services to a non-resident of their country whose actual residence may be in another member state or outside of the EU? Would they be required to compute three different rates of VAT for the same service? If so then one element of distortion has given rise to another.

The proposed rule would also cause a problem for mobile operators in some EU countries with regard to "pay as you go" (PAYG) customers. In some member states the mobile phone companies are not required to register the details of its PAYG customers and therefore do not know where the customer is established. If the proposed rule comes into force mobile operators would be forced to implement systems to register its new and existing PAYG customers and verify that the details they provide are correct. This counters much of the appeal of the PAYG market.

This issue of double taxation when a customer roams outside the EU is expressly covered by the use and enjoyment provisions as contained in the 6th Directive Article 9(4). However, Member States are given the option of introducing these provisions and not all have leading to a disparity of treatment throughout the EU.

- *Do you have any remarks on the outlined exclusions to the general rule, more specifically for the following services:*

– *Passenger transport services*
– *Restaurant and catering services*
– *Short term hiring of means of transport*
– *Exhibitions, fairs, cultural events etc.*
– *Services capable of being supplied at a distance*

ETNO is only commenting on "services capable of being supplied at a distance".

To specifically exclude services capable of being supplied at a distance from the general rule (and to impose the customer's establishment as the correct determinant for calculating the place of supply) seems to be placing a huge administration burden only on a small number of business sectors (though it should be recognized as a significant set of businesses in terms of employment, revenues etc). In addition, this is not going to present an appealing administrative environment to encourage new and emerging EU businesses into these sectors and places on existing EU businesses significant extra administrative burdens and complications. Whilst, as mentioned above, the typical customer base is established in the same country as its network provider

there are always exceptions and using the customer's establishment rule will provide for major changes to billing rules and customer pricing that would be disproportionate to the perceived failure of the current rules.

The proposed rule would not only place additional burdens on the telecom service providers but also on third party content providers. For example, in the UK content (i.e. music, video clips, pictures, news etc.) is, in some cases, provided directly to the customer by the content provider. The telecommunication service provider (or Internet Service Provider) merely acts as an agent by transporting that content to a customer via the phone (mobile or fixed, TV, PC etc). The proposed rule would mean that if the content provider is established in a different member state to the customer they would need to account for VAT at the rate applicable in that country. Some content providers are SME's who may not benefit from exemption under Article 24 in that Member State. This is an issue which the Commission identified in the consultation paper with regard to a more general rule of taxing at the rate applicable to the country in which the customer is established.

The proposed rule also appears to curtail a consumer's freedom to purchase services cross border within the EU. At present a consumer can purchase goods in any EU Member State and bring it back into their own country. (There are rules in place with regard to businesses "distance selling" but these do not prevent a consumer for arranging purchase and transport of goods they themselves purchase). There are certain conditions applied by some Member States (e.g. prohibited goods, excise goods not purchased for personal use, purchase of new means of transport). A consumer should have the same right for purchasing services. It should be possible for a consumer to purchase a service in the same way as goods from whichever EU supplier gives them the most competitive price. By their very nature some services can be purchased at a distance but the consumer is still effecting the purchase. For example, if a private individual wishes to purchase and download a song, they will connect to the internet using their chosen internet service provider select the song they wish to download, pay the provider and download the song. The customer is effecting the transaction and arranging "transport" via their telephone (or similar) internet connection. The fact that the consumer has not left their desk should not curtail their choice to select the best price available within the EU.

The consultation paper makes the point that there is empirical evidence that non-EU traders are setting up a fixed established in Member States with the most attractive VAT rates. Equally EU businesses are changing their place of establishment for the same reason. This is not disputed but surely this is an issue to do with tax harmonization of the rates in the different Member States. Each Member State sets its rate in line with EU legislation and whichever rate they choose it is their decision. If they set a rate higher than that of their neighbours that is their choice. Businesses and consumers should not be disadvantaged because the Commission and the Member States cannot agree

on a harmonized VAT rate for the EU as a whole. This harmonization of the VAT rates will be the only way that the Commission will achieve the ambition of "the principle of trade on a level playing field".

• *Do you have any other comments regarding the review of the place of supply of services that you wish to make?*

It is interesting to note that the Commission believes that a general rule based on where the customer is established is feasible only once the one-stop mechanism is adopted and would "impose disproportionate burdens on traders, which is not in line with the conclusions reached at the Lisbon summit". However, the Commission is proposing that such a currently unfeasible and disproportionate rule be applied to Article 9(2)(e) services that can be supplied from a distance.

The Commission states that it "considers that a new regime for B2C services is not practical at present." This infers that there will be a new regime introduced at some stage in the future. To introduce changes now that could be reversed or amended in a future exercise seems to be an inefficient use of resource for legislators, tax authorities and businesses. The perceived failure of the existing rules especially in relation to digital services, is primarily as a result of the E-Commerce directive which encouraged businesses to either use the simplified VAT return filing procedure (the for runner of the "One Stop Shop" proposal currently under discussion) or to set up a full establishment within one Member State. It seems unfair that businesses are being further punished with even more administrative burdens when the commission is not thinking long term

The Commission should be working toward one rule for all supplies of services from business to non-taxable customers and avoid creating a number of different rules which add a further administrative burden to businesses and have no benefit for the final consumer.