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## Value Added Tax (VAT) on Online Sales in the European Union

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Starting July 1, 2003, businesses based outside of the European Union (EU) supplying digital goods and services (such as downloadable software, video and music) to consumers in the EU will generally be required to charge, collect and account for VAT on such sales. We have previously discussed this requirement in our [March 6, 2002 Internet Alert](#).

VAT is a tax that is imposed on the supplier of goods and services. The rate of VAT varies across the EU, although it is generally between 15 and 25%. The seller normally passes the VAT charge onto the buyer, and the seller accounts for that VAT to the relevant EU tax authority. Since VAT is a sales-based tax, its administration and collection is usually dependent upon where the seller (or occasionally, the buyer) in question is physically present, or, in other words, where the sale is treated to have taken place.

### **B2C Activity**

Under existing rules, non-EU businesses are not required to charge VAT on supplies to EU customers. Under the new rules, many non-EU based businesses will have to charge VAT on their sales to "consumers." For these purposes, sales are to consumers unless the sale is for the business purposes of the buyer and the buyer is able to provide the non-EU seller with the buyer's VAT registration number.

The most administratively complex area of the new rules is that the rate of VAT that non-EU sellers will have to charge will vary depending upon the EU Member State in which a given EU consumer is resident. For example, a U.S. supplier of music downloads would have to charge VAT at a rate of 19.6% on sales to French consumers, 17.5% on sales to UK consumers, and 25% on sales to Swedish consumers.

If you are a non-EU supplier providing electronically supplied services (and for the purposes of VAT, all goods delivered electronically are treated as supplies of services) to consumers in the EU, you are potentially required to register and account for VAT in every Member State where your consumers are resident. However, a simplified special scheme (the Special Scheme) permits you to register electronically in a Member State of your choice and account for VAT on a single electronic VAT return (although the amount of VAT to be paid will still vary according to the place of residence of the

consumers). The relevant revenue authority in the Member State in which you have registered will then distribute the VAT to the Member States in which your consumers are resident. Guidelines relating to the Special Scheme have recently been published by the UK's relevant tax authority—HM Customs & Excise (HMCE).

### **Consumer Location and Status**

In order to comply with the new rules, it will be necessary for non-EU based businesses to identify the status and location of a consumer in order to determine whether they are liable for and, therefore, have to charge VAT and, if so, at what rate.

For sales to business customers in the EU to be treated as B2B sales (see below), and thus outside of the new rules, the non-EU seller is required at the time of the transaction to obtain the customer's VAT registration number and country identification code prefix.

For sales to non-business consumers (B2C sales), a consumer's self-declaration as to his location is acceptable if any of the following conditions is satisfied:

- the consumer's postal address has been provided and goods have been successfully delivered there;
- on accepting payment, the consumer's home address and billing address are compared (or satisfactory alternative evidence is provided if the match is unsuccessful);
- on accepting payment, the consumer's country of residence and the location of the issuing bank are compared (or satisfactory alternative evidence is provided if the match is unsuccessful);
- "geolocation" software or proprietary software is used; or
- systems that are configured to identify where the service is consumed (e.g. telecommunications services) are used.

In the cases where alternative methods are employed, the non-EU based business should consult with the Member State in which it has registered or the appropriate authorities in each Member State.

### **Electronically Supplied Services**

The new rules cover, for example, the following types of services:

- Website supply, web hosting and distance maintenance;
- Music downloads;
- Film, video and photographs;
- Software and software maintenance services;
- Text and other information, including online news, instant messages, database access, stock prices and sports results;
- Online publications, including books, newspapers and magazines;
- Online games;
- Online auction services; and

- Certain distance teaching and educational materials.

Note that the rules are relatively broad and would include services provided through both e-commerce and m-commerce.

### **Problems with the New Rules**

Under the new regime, a non-EU based business that has no establishment or affiliate in the EU may suffer a disadvantage compared to businesses based within the EU. These disadvantages include having to charge differing rates of VAT because of the varying VAT rates in different countries (suppliers based in the EU charge VAT at the rate applicable in the country in which they are established, regardless of the location of the consumer), and increased technological and administrative costs associated with pricing to take account of the different VAT rates and dealing with multiple tax authorities in different languages.

Also, non-EU businesses registered for VAT in an EU Member State under the new Special Scheme will only be able to recover VAT that they themselves have paid to suppliers (known as input VAT) under a special procedure known as a "Thirteenth Directive Reclaim". This procedure is both complex and time-consuming. Suppliers who are established in the EU and registered for VAT under the normal rules are able to recover input VAT under a much more straightforward procedure.

Incorporating a local subsidiary or establishing a branch in the EU could solve these potential problems for a non-EU business, but the costs of establishing and maintaining the subsidiary or branch and the income tax and other consequences of such a move would have to be considered.

### **Enforcement**

It is not yet known how the EU will enforce the new rules, although it seems that no special enforcement measures are to be introduced. The EU Commission is taking the view that non-EU businesses will voluntarily comply with the new regime. It remains to be seen whether the EU Commission will be proved right, although it should be noted that various jurisdictions, notably the US, have adopted strict new rules relating to compliance and disclosure as a result of the numerous recent corporate scandals. Such new rules make it more likely that businesses will choose to comply. In any event, it will be the relevant tax authorities in Member States that oversee compliance, and it is possible that different authorities will take different approaches.

### **B2B Activity**

In the case of business-to-business transactions between non-EU suppliers and EU business customers, the VAT position is not changing. Under the "reverse charge" procedure, a business customer receiving a supply of services from a non-EU supplier is generally treated as having made the supply to themselves, and they must account for the VAT on the supply in their own EU Member State (although they should get full input tax recovery). In other words, the non-EU supplier is not required to pay VAT on such sales.

### **EU Member States**

Currently, the Member States of the EU are as follows: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom.

The following States are due to join the EU on May 1, 2004: Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic and Slovenia. Bulgaria, Romania, and Turkey have also indicated a desire to join the EU, although it is not known whether, or when, they may join. Therefore, U.S. suppliers of digitized services may also be caught by the new rules in these additional countries in the future, as they become members of the EU.

General information on the new rules has also been published by HMCE and the EU.

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