VAT TIPS AND TRAPS ON CROSS BORDER SUPPLIES

Managing the Risks

The new B2C place of supply rules coupled with the new extended Mini One Stop Shop for telecoms, broadcasting and electronic services are soon to launch (1 January 2015). There are already appearing some gaps in the rules and some pitfalls to avoid. This publication points out 10 practical issues to focus on in relation to the new regime, and for all businesses when managing their cross-border supplies, both B2B and B2C. VAT on cross border supplies is only becoming more complicated and the scope of what constitutes a fixed establishment appears to be widening.

Changes to rules affecting Telecoms, Broadcasting and electronic services

There are important changes to the VAT rules affecting B2C cross-border services from 1 January 2015 (details of which are set out in our earlier alert). These changes will affect those businesses both inside and outside the EU which are directly or indirectly involved in the supply of telecommunication broadcasting and electronically supplied services (**"TBE Services"**) where the customer is a private individual or an organisation that is not in business.

To end distortion between EU and Non-EU based businesses, from 1 January 2015, the place of supply of TBE Services for both EU and non-EU suppliers will be the non-business customer's place of "belonging". This means generally (in the case of individuals) where the customer has his permanent address or usually lives (Article 58 Principal VAT Directive, PVD), or in the case of non-taxable legal persons, the place where the functions of its central administration are carried out or where there are sufficient human and technical resources. However, where in relation to these services a particular jurisdiction provides that VAT should be charged where the service is "effectively used and enjoyed" (within the EU), and not where the customer belongs, outside the EU, VAT will be charged in the place of use and enjoyment.

For B2B cross-border transactions the customer will still be liable to account for any VAT due through the reverse charge mechanism ie the business customer will account for VAT in its jurisdiction. However, in a B2C supply, the reverse charge is not possible. As a result liability to account for any VAT due in a member state will rest entirely with the supplier.

An important additional change sitting side by side with the new place of supply rules, which is of critical importance to the EU Commission, is that the one stop shop which currently only applies to Non-EU businesses providing electronic services and allows payments and returns to be made electronically from a single Member State of Identification, has been extended to EU businesses. It will cover not only electronic services, but also telecommunications and broadcasting services. It is an optional scheme referred to below as MOSS (Mini One Stop Shop). This was introduced by Commission Implementing Regulation 815/2012, and in the UK, further regulations have been now made, the VAT (Amendment) (No. 3) Regulations 2014. The Union Scheme applies to businesses with an EU business and a parallel scheme, the Non Union Scheme, applies to businesses without any establishment in the EU. Bizarrely, if the Non EU business is already registered for VAT in EU, albeit it has no EU establishment, it cannot use either Scheme and will have to register in each Member State where it has a customer in the usual way. MOSS will reduce the administrative burdens which the change in the place of supply rules could have

led to, because EU suppliers will not have to register in every member state where their customers belong and indeed will no longer be liable to be registered in jurisdictions where they do not have establishments if TBE Services are the only supplies they make. The success or failure of the MOSS, not least from a technology point of view, is critical to how VAT accounting may develop in the years ahead especially given the debacle over the introduction of the electronic portals opened for EU VAT refunds.

This publication assumes a working understanding of these new rules (for which see our earlier alert) and aims to identify ten practical risks and how to manage them. The first seven relate to TBE Services specifically, the last three relate to cross-border supplies generally. References to Articles below are to the EU Implementing Regulation 282/201 as amended by Implementing Regulations 1042/2013/EU with effect from 1 January 2015.

TBE SERVICES B2C - THE NEW REGIME: MANAGING THE RISKS

1. Knowledge of rules in Member State where the customer belongs

Irrespective of whether or not a supplier registers for the MOSS, it will need to know the relevant VAT rules in the Member States where its customers are established, where it will need to account for VAT. The rate of VAT will depend on the law in the Member State where the customer is based, as will the invoicing rules, claims for bad debt relief, and the rules for correcting errors. Furthermore, when a default takes place, it will be the Member State where the VAT is due that will take action applying its own rules on penalties and interest. For example, a supplier can make amendments to its MOSS returns up to three years after the end of the relevant period (Article 61(2)). However, the laws in the Member State where the customer is based "remain unaffected". For example the local laws may provide that amendments to a return can be made up to five years after the end of a period, and therefore, after four years, it would be necessary for the supplier to contact the Member State where the customer is based directly, because such corrections cannot be made as part of the MOSS scheme. It will be necessary therefore to be able to have access to reliable VAT advisers in the Member States of the customers. Registering under MOSS will not alleviate this.

2. Input VAT reclaims

MOSS only deals with (output) VAT due on B2C supplies of TBE Services. It does not deal with reclaiming input VAT incurred on business expenditure incurred in the jurisdiction where the customers are based. To reclaim this VAT, where the business does not have an establishment, it is necessary to apply the rules under the Refund Directive for EU based suppliers (EU Council Directive 2009/9/EC), and the 13th Directive for non-EU established suppliers (86/560/EC). Interestingly, one of the requirements of both schemes is that the claimant has not made supplies of goods or services in the jurisdiction where the VAT reclaim is being sought (with some limited exceptions, Article 3 2008/9/EC). It seems that VAT reclaims under these Directives are permitted in a Member State notwithstanding that B2C TBE supplies are made to customers belonging there.

3. Involvement of intermediaries

Where B2C TBE services are supplied through an on line portal, gateway or marketplace, the supplier needs to establish whether it is liable to account for the VAT on the B2C supply or whether it is treated as making a B2B supply to the intermediary, with the result that the B2C supply is made by the intermediary. There is a legal

presumption that the intermediary is making the B2C supply and is liable for the VAT (Article 9a). Where the intermediary sets the general terms and conditions or authorises payment or delivery, or does not clearly state the name of the original supplier on the receipt or invoice issued to the consumer, then the intermediary will be seen as making the B2C supply. Section 3 of the European Commission's Explanatory Notes on the EU changes to the place of supply of TBE Services, published 3 April 2014 gives a number of examples, of how these rules should be applied, involving content owners, aggregators, app stores and consumers. It is critical for both suppliers and intermediaries to know who is going to be responsible for the VAT. If the original supplier is to remain liable for the VAT on the B2C supply, the contractual arrangements must reflect this. Note that an intermediary who only processes payments is not liable for the VAT on the B2C supply. We expect that there will continue to be much confusion in this area and if the wrong party accounts for the VAT, in law, that does not relieve the person legally liable from its VAT obligations. Problems build up over time and the amounts involved can become very significant. In these troubled times, it is by no means certain that Member States will be lenient in this area. We expect intermediaries at the end of a chain of supply will wish to account for the VAT, rather than pass it on, except in the clearest of cases, and after a thorough review of the contractual arrangements by a reliable lawyer!

4. Non-EU providers of electronic services - past supplies

It would have been prudent, at the same time as introducing these new rules, to grant an amnesty of some sort to those non-EU businesses who have not been fully compliant with their EU VAT obligations, whether out of lack of knowledge and awareness, or otherwise, to encourage them to register for VAT under the new MOSS. However, no such amnesty has been granted, and accordingly non-EU businesses, which become aware of their EU VAT obligations, face a dilemma because if they register for VAT now, their past supplies may come to light. Each Member State will take its own view on past defaults and apply its own penalties. It should be noted that the UK has said it will use existing bilateral treaty agreements to pursue any outstanding UK VAT that may become apparent or is brought to the UK's attention, and it can be expected that other Member States will apply the same principles. Our advice is that non-EU customers should come forward and make voluntary disclosures to limit the risk to the business in the future.

5. Establishing the customer as a non-business consumer

TBE Services supplied B2C generally involve a high volume of low value supplies and it is particularly important that the supplier is able to establish the business status and location of its customers rapidly and with certainty. Generally, a supplier of services will treat a customer as being a taxable person, even if it has no VAT registration number, where the customer can show it is in business and has applied for a VAT registration. But, pursuant to Article 18(2), in the case of TBE Services, unless the supplier has actually received the evidence of the customer's VAT registration number, by the time of the supply, the supplier may always treat him as non-business. The risk is on the supplier because if it accepts alternative business evidence of the customer being in business and the alternative evidence is insufficient for any reason, the supplier will be liable for the VAT and penalties. Of course, if the VAT registration number is supplied after the supply takes place, and it is clear that the registration was in effect at the time of the supply, then the supply should be treated as B2B after all and the supplier should make corrections. In the UK, the supplier may still choose to accept alternative evidence of business status. Nevertheless we understand some Member States may insist on VAT being accounted for where a VAT registration number has not been produced irrespective of alternative business evidence.

6. Establishing where the consumer is located - presumptions and rebuttals

Articles 24a and 24b lay down a sensible set of rules to determine where a consumer is located in relation to specific supplies. For example, if services are provided at a location such as a Wi-Fi hotspot, internet café, restaurant or hotel lobby where the physical presence of the customer is needed, there shall be a presumption that the service if supplied by the hotel is supplied there (Article 24a). This avoids a hotel providing wi-fi in its lobby needing to register for VAT in every jurisdiction where its guests are resident. These presumptions can be rebutted by the supplier - not the customer - with three pieces of non-contradictory evidence. A tax authority can

only rebut the presumptions if there are indications of "misuse or abuse by the supplier": Article 24(d). In our view there seems little purpose in any supplier seeking to rebut; best is for the supplier to ensure that the evidence that the supply properly falls within Article 24a/ Article 24b is collated by the system and retained for 10 years (if MOSS applies) rather than overcomplicate the position.

7. Transitional Rules

The existing rules will span 1 January 2015, and where VAT has already been accounted for under the existing old rules, VAT does not need to be accounted for again under the new rules. For example, if a consumer pays a single sum for an annual subscription in April 2014, the supplier will be taxed under the current rules. However, if the consumer takes out an annual subscription in April 2014, paying it on a quarterly basis, the first three payments will be accounted for under the current rules, and a final quarterly payment in January 2015 will be taxed under the new rules. It should be noted advance payments only operate to accelerate the supplier's tax point if they are consistent with the supplier's existing billing practice; the issue of an (early) invoice does not trigger a tax point.

OTHER SERVICES: B2B AND B2C SUPPLIES: MANAGING RISKS

8. Effective use and enjoyment

Where a supplier is supplying services to a customer (B2C or B2B) knowing that they will be consumed, or used, in the EU, albeit that the consumer belongs outside the EU, it is important to check the rules of the jurisdiction where the services are enjoyed, to determine if that jurisdiction taxes the services where they are used and enjoyed. The effective use and enjoyment rule trumps the general place of supply rules. The UK only applies the effective use and enjoyment rule to hiring of goods, telecoms services and to B2B electronic services, but other countries have more stringent rules eg Italy applies use and enjoyment to advertising services: Athesia Druck C-1/08. The risk is certainly greatest where the supplier is established in the same jurisdiction where the use and enjoyment takes place and indeed Athesia Druck is authority for the proposition that effective use and enjoyment rule does not apply if the supplier is not established where the use and enjoyment takes place. The UK somewhat generously takes the view that in a chain of supplies, the supplier only needs to consider the use by the immediate customer in the chain, not the ultimate consumer. Nevertheless any use by the recipient of the supply could amount to effective use and enjoyment whatever the purpose of that use.

9. Intervention - goods and services

Another provision that can upset the general rules for place of supply of goods and services is "intervention". This is a weapon increasingly used in the EU, for example France, but historically of less interest to HMRC, who have never been very interested in "force of attraction" arguments except in the most blatant of cases. Under Article 53, and Article 192a of the PVD, where a supplier has a fixed establishment in the jurisdiction of its customers, and that fixed establishment has an involvement in the facilitation of the supply that goes beyond simple administrative tasks such as invoicing and debt collection, the fixed establishment can be liable for local VAT on the entire supply. The danger for example, in the case of services, arises in relation to technical services supplied as part of an overall contract (eg installation) or as an after-sale service. Common ways to avoid the problem are avoiding creating a fixed establishment in the jurisdiction where the customers are based, by reducing human and technical resources, or incorporating the branch into a subsidiary (but note DFDS A/S Case C-260/95).

10. Have you created a Fixed Establishment?

The existence of a "fixed establishment" in a given jurisdiction is one of the most important and topical VAT issues in cross-border transactions, as it impacts on so many VAT issues, to name but a few: does intervention apply? Can the business continue to make reclaims under the Reclaim or Thirteenth Directive? Does VAT need to be charged locally by the fixed establishment? If there is a fixed establishment making TBE supplies, MOSS cannot apply to the supplies to customers in that jurisdiction etc. Does it mean there is a permanent establishment for direct tax? The definition of fixed establishment (Article 11) means that there must be a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to receive and use the services supplied to it for its own use. Following case law:

- a subsidiary can be a fixed establishment *(DFDS) ECJ C-260/95*; this case held that a subsidiary acting as agent or as an "auxiliary organ" of its parent, could constitute a fixed establishment of the parent;

- the human resources do not need to be employees but can be consultants *(Astral Marine Services Ltd (TC 03408)*);

- infrastructure belonging to one company may be a fixed establishment of a different company *(Welmory Sp zoo C-605/12* decided by the Court of Justice on 16 October 2014). The context was a Polish company (Welmory) had a collaboration agreement with a Cypriot company which provided that the Cypriot company would manage the Polish company's website, on which auctions took place. The Cypriot company used the Polish company's human and technical resources to manage the website. The Court was asked to deal with the question whether the infrastructure belonging to the Polish company could constitute a fixed establishment of the Cypriot company. The Court decided that it is irrelevant whether or not there is an economic link between the two companies. The Advocate General, confirmed by the Court, decided that the test was simply whether the Cypriot company had a sufficient degree of permanence and human and technical resources in Poland to allow it to receive and use the services for its own business. It was up to the national court to determine if there was a sufficient structure in terms of human and technical resources such as appropriate computer equipment, servers and software to constitute a fixed establishment. It appears that some human resource is still necessary.

This is a critical area, and one to watch.

CONCLUSION

The EU VAT rates on cross border supplies are constantly changing, and companies are expected to keep fully up to date with changes and adapt their systems and contracts accordingly.

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