Innovation

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New VAT regime for "business to consumer" suppliers of telecoms, broadcasting and electronic services

With effect from 1 January 2015, a new VAT regime will apply across Europe for "business to consumer" suppliers of telecoms, broadcasting and electronic services. This new regime will have a material impact on corporations engaged in the supply of certain products (e.g. download software) and services over the Internet, smart phones or other the distribution channels e.g. via "Apps". This will provide an opportunity to rationalise or otherwise consolidate existing European tax, distribution and operational structures and to eliminate complexity and drive further costs savings. In particular it will also provide the opportunity to combine European wide substance in a single location and may enable companies to rationalise costs in this structure.

Background

VAT is a tax on consumption (but is structured very differently to sales tax in states in the US). It is collected by VAT-registered traders on their supplies of goods and services effected within the European Union for consideration. Each such trader in the chain of supply charges VAT on his or her sales and is generally entitled to deduct from this amount the VAT paid on his or her purchases (with limited exceptions, e.g. education, financial services etc.). VAT is generally not "suffered" at the trader level, the final consumer who is not registered for VAT, economically bears VAT as part of the purchase price.

This document contains a general summary of developments and is not a complete or definitive statement of the law. Specific legal advice should be obtained where appropriate.

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The VAT rate to be applied is determined by the "place of supply" rules. The place of supply of goods is generally where the goods are located at the time of supply. The place of supply of services is a little more complicated. For business to consumer ("**B2C**") supplies of services of telecoms, broadcasting and electronic services, the current "place of supply" rules (which will change on 1st January 2015) provide that the VAT to be applied is the VAT of the supplier's home Member State regardless of the end place of supply (i.e. not the Member State of residence of the customer, if different). It should be noted that different countries in Europe have different VAT rates and this fact is a relevant factor in determining the country where traders are established to deliver "online" services.

Companies can engage in a degree of planning and put in place certain structures that allow them to locate their substantive activities in one EU Member State yet supply the services for VAT purposes from a lower VAT jurisdiction. Under the current VAT regime, it is common for B2C internet companies to locate substantive trading activities in Ireland to benefit from numerous advantages available and to route their supplies through a Luxembourg company as Luxembourg applies the lowest permissible VAT rate of 15%. This means that despite the fact that no substantive activity may be carried on in Luxembourg, the VAT rate applied is 15% (i.e. the maximum revenue is retained).

Current VAT Regime Supplies of telecoms, broadcasting and electronic services to customers at the standard rate			
Supplier Location	Customer Price	VAT	Post-VAT Net Amount Retained by Supplier
Germany	€100	19%	€84.03
France	€100	19.6%	€83.61
Ireland	€100	21%	€82.65
UK	€100	20%	€83.33
Luxembourg	€100	15%	€86.96

Future Developments in the EU VAT Regime

A package of changes to the EU VAT system was adopted by EU Finance Ministers in February 2008. The changes will modernise and simplify the current rules relating to cross-border supplies of services and to the recovery of VAT on purchases made in other EU countries.

From 1 January 2015, the place of supply of B2C supplies of telecoms, electronically supplied services and radio and television broadcasting within the EU will be the country where the customer is established or usually resides and NOT from the country from where the service was supplied. Therefore, in the case of these supplies there will be no particular VAT benefit from locating invoicing functions in a low VAT jurisdiction as the VAT rate will be variable in accordance with the place of residence of the customer who received the services.

This would normally require businesses to register for and pay VAT in the customer's Member State of residence. However, suppliers will be permitted to discharge their VAT obligations using a "one stop shop" scheme which will enable them to fulfil their VAT obligations (registration, declaration and payment) in their home Member State, including for services provided in other Member States where they are not established. For example, a Luxembourg invoicing operation (which will typically have its own corporate structure as well) could be discontinued and the country (e.g. Ireland) in which the substantive business activity is located could supply the customers directly. This would not incur additional VAT cost and could provide for operation cost savings by consolidating the two separate functions and corporate structures into one location.

VAT Regime from 1 January 2015 Supplies of telecoms, broadcasting and electronic services to customers at the standard rate				
Customer Location	Supplier Location	Customer Price	VAT	Net Amount Retained by Supplier
Germany	Ireland	€100	19%	€84.03
	Luxembourg	€100	19%	€84.03
France	Ireland	€100	19.6%	€83.61
	Luxembourg	€100	19.6%	€83.61
UK	Ireland	€100	20%	€83.33
	Luxembourg	€100	20%	€83.33

There are significant benefits in locating both substantive and invoicing functions in one jurisdiction in order to minimise the costs associated with maintaining a presence in multiple countries. In addition to VAT neutrality, the positive foundations in Ireland remain and continue to make Ireland a very attractive place in which to do business namely:

» very good and improving infrastructure including third party outsource partners for invoicing and fulfilment;
» high-quality, readily available and competitively priced human capital;
» energy costs, wages and rents have fallen to make Ireland more competitive in the global context; and
» 12.5% tax rate on trading activities

Conclusion

The change in the place of supply rules will serve to negate the VAT advantages associated with internet companies locating their invoicing functions in a Member State that is different from where they locate their substantive activities. When the new place of supply rules for the supply of electronically supplied services come into force on 1 January 2015 then the VAT rate levied will be that which prevails in the customer's Member State. This will allow for both substantive activities and invoicing functions to be located in Ireland. This will serve to reduce costs for businesses and allow streamlining of corporate structures and businesses should consider this in their planning.

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