



COMMISSION OF THE EUROPEAN COMMUNITIES

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Proposal for a

**COUNCIL DIRECTIVE**

**amending Directive 77/388/EEC as regards the place of supply of services**

(presented by the Commission)

## **EXPLANATORY MEMORANDUM**

### **1. INTRODUCTION**

In July 2000, the European Commission stated its intention to put forward a number of new proposals in the VAT area as part of its new VAT strategy.<sup>1</sup> Modernising the rules on the place of supply of services was identified as one of the future priorities.

On 7 May 2002, the E-Commerce VAT Directive<sup>2</sup> amending and amending temporarily Directive 77/388/EEC as regards the value added tax arrangements applicable to radio and television broadcasting services and certain electronically supplied services was adopted. At that time, it was announced that this Directive would be the last individual change to Article 9 of the Sixth VAT Directive<sup>3</sup> before a more general and thorough review of the rules governing the place of supply of services in totality. Furthermore, in statements entered in the minutes of the meeting at which the Council adopted that Directive, several delegations called upon the Commission to accelerate this review. In particular they asked that the current distortions in the internal market concerning cross-border hiring of means of transport be considered.

The aim of this proposal is to bring about the first part of the reform of the rules on the place of supply of services. It deals with supplies between taxable persons. Supplies whereby the customer is a non-taxable person will be addressed in a subsequent exercise.

### **2. BACKGROUND**

Since work first started in the 1960's on the introduction of a common VAT system in the Community, the view has been that taxation of services should take place in the Member State of consumption.<sup>4</sup> However, during discussions on the Sixth VAT Directive it was recognised that systematically defining the place of consumption as the place of taxation could lead to some serious practical problems. As a result, it was decided that the basic rule for the place of supply of services – and therefore the place of taxation – is where the supplier is located. For any service to be taxed anywhere else it must explicitly be excluded from the basic rule.

At that time, to a very large degree, these rules in fact resulted in the tax accruing to the country of consumption. However, the realities of the Internal Market, globalisation, deregulation and technology change have all combined to create enormous changes in the volume and pattern of trade in services. It is increasingly possible for a number of services to be supplied at a distance. In response, a series of amendments to the Sixth VAT Directive have been taken to address this problem over the years and many defined services are in fact taxed where the customer is located.<sup>5</sup> For the most part, these changes have involved supplies made to taxable persons, since there has always been a simple mechanism (i.e., the reverse

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1 COM (2000) 348 Final, 7 July 2000 'A strategy to improve the operation of the VAT system within the context of the internal market'.

2 Directive 2002/38/EC adopted 7 May 2002.

3 Sixth Council Directive 77/388/EEC of 17 May 1977

4 Article 6(3) of the 2nd VAT Directive provided that the place of the provision of services shall, as a general rule, be regarded as being the place where the service that is provided, the right that is transferred or granted, or the object that is hired, is used or enjoyed.

5 Article 9(2)(e) of the Sixth VAT Directive lists services that are subject to taxation based on where the customer is established.

charge mechanism) for dealing with the taxation of such supplies. On the other hand, supplies to non-taxable persons are for the most part subject to VAT where the supplier of the service is established.

Over the course of the last year, there were three separate consultations with the Member States in Working Party No 1 in order to discuss problems with the place of supply rules for services and how best to resolve them. Additionally, a public consultation was undertaken on this matter in May-June of 2003. Over 50 written responses were received from industry associations and businesses from many different countries.

The consultations support, generally, the review of the place of supply of services rules as it is acknowledged that the existing rules are problematic. At the same time, it was recognised that any changes in this area must balance the control needs for the tax administrations and the administrative obligations for the traders, while respecting the basic principle that VAT should accrue to the Member State where consumption occurs.

As a result of the aforementioned consultations, a number of parameters with respect to the proposal have been established.

### **3. THE PARAMETERS OF THE PROPOSAL**

The Commission considers that any modification of the rules governing the place of taxation of services should result, to the greatest extent possible, in taxation at the place where the actual consumption takes place. Furthermore, the proposal on the place of supply of services should seek a balance between the control needs for tax administrations and the administrative obligations for traders. Taxation at the place of consumption should only be pursued as far as it does not lead to additional obligations.

#### **3.1. Taxable Persons**

For all services provided to taxable persons, the place of taxation should be the place of consumption. Businesses use the services provided to them in order to produce goods or other services. The cost of these services is included in the price of the goods. Therefore one could well argue that for most, if not all, services the place of consumption is the place where the customer has established his business. That is the place where the services are consumed.

In the provisions in force there are 21 different sub-rules applicable to the place of supply of services and 14 of these rules<sup>6</sup> already use the place of establishment of the customer (or the Member State which issued him a VAT number) for cross-border supplies of services. The tax is collected via the self-assessment or reverse charge mechanism. Depending on the nature of the business (e.g., taxable activities), there may exist a corresponding right of deduction for the taxable person.

#### **3.2. Non-Taxable Persons**

Services supplied to non-taxable persons or final consumers should also follow the general principle that they should be taxable at the place where the actual consumption takes place.

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<sup>6</sup> Article 9(2)(e) first indent, second indent, third indent, fourth indent, fifth indent, sixth indent, seventh indent, eighth indent, ninth indent, Article 9(2)(f), Article 28b(C), Article 28b(D), Article 28b(E) and Article 28b(F).

Contrary to the supply of services to taxable persons, for services provided to final consumers it is even more crucial to determine the place of consumption, as this VAT is not deductible and therefore forms part of the revenue of the Member State.

While application of the general rule of taxation at the place where the customer is established or domiciled would reflect better taxation at the place of consumption, it would also lead to significant practical problems at this point in time. It is not realistic to expect final consumers to self-assess tax (i.e., use the reverse charge mechanism) on services acquired in another Member State for consumption where they are established or domiciled. The alternative would be to require providers of services to register in every Member State of consumption in order to collect and remit tax to the Member State where the non-taxable person is established or domiciled. This would, however, entail a great deal of additional administrative burden on business, which would not be desirable.

### **3.3. Scope of the Proposal**

As a result of detailed discussions with Member States and a public consultation, which concluded 30 June 2003, a number of parameters with respect to the proposal have been established. At present, the focus is solely on amending the provisions relating to supplies to taxable persons (i.e., B2B supplies). The issue of supplies to non-taxable persons (i.e., B2C supplies) will be addressed subsequently. In this context, however, the Commission considers that the introduction of a mechanism which will enable tax to be collected in the country of consumption without creating undue administrative complications is an essential prerequisite. This would be, in effect, a 'one-stop shop' similar to that currently in operation for non-EU established suppliers of digitised services. The Commission services will monitor closely the workings of this mechanism, which would appear to have a potential for a broader application in the intra-community context.

## **4. THE PRESENT RULES FOR TAXABLE PERSONS AND PROBLEMS ENCOUNTERED**

The general rule for the place of supply of services deems the place of taxation to be where the supplier has established his business or has a fixed establishment from which the service is supplied or, in the absence of such a place, the place where he has his permanent address or usually resides.<sup>7</sup> Complementing this rule, are a number of exceptions<sup>8</sup> which override the general rule and can cause the place of taxation to change depending on the nature of the supply.

These exceptions exist for services related to immovable property, transport services – both passenger and goods, services that are of a cultural, artistic, sporting, scientific and educational nature, work on movable tangible property and intangible services, including copyrights, patents, advertising, professional services (e.g., engineers, lawyers, etc.), the supply of staff, the hiring out of movable tangible property, telecommunications, radio and television broadcasting and electronically supplied services.

The structure of these rules results in a number of problems. The following list, while not comprehensive, gives an overview of the types of problems encountered. It should also be noted that the following problems could equally apply to supplies to non-taxable persons.

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<sup>7</sup> Article 9(1)

<sup>8</sup> Article 9(2)

#### **4.1. General Problem**

A general problem that arises from Article 9(1) is the obligation for taxable persons who receive a service but are not established in the same country as the supplier of the service, to ask for a refund under the Eighth or Thirteenth Directives. The refund procedure can be complicated and very time-consuming. In order to avoid this procedure, there is often a tendency to inappropriately use the reverse charge mechanism.

#### **4.2. Forms of transport**

The place of taxation of a “form of transport” has caused some disputes. Since forms of transport may easily cross frontiers it is difficult, if not impossible, to determine the place of their use and in each case, a practical criterion must therefore be laid down for charging VAT. Consequently, for the hiring out of all forms of transport, the Sixth VAT Directive provides that the service should be deemed to be supplied, not at the place where the goods hired out are used, but, with a view to simplification and in conformity with the general rule, at the place where the supplier has established his business.

Due to the different rules on the deduction of VAT for automobiles that are applicable in the Member States, the cross-border hiring of motor vehicles, especially the long-term leasing to taxable persons, is problematic. It creates a tax incentive for taxable persons in certain Member States to lease automobiles, used for business purposes, in another Member State rather than obtaining the automobiles in their own Member State in order to benefit from more favourable deduction rules.

The scope of the meaning of “forms of transport” also causes problems. It has been discussed in the VAT Committee whether trailers, semi-trailers, containers and pallets should be included within the scope of “forms of transport” and therefore their hire should be excluded from Article 9(2)(e).

#### **4.3. Registration in Other Member States**

In many instances, a service provider may supply services in respect of movable tangible property in a Member State other than where they are established. The VAT is due in the Member State where the work was performed. At present this means that the service provider may be required to register with the tax administration in that Member State and pay VAT. For many businesses this can prove administratively onerous, especially where they carry out activities in a number of Member States (e.g., pan-EU service and maintenance contracts). The control of such businesses can also prove burdensome for tax administrations.

#### **4.4. Intangible Services (The Interpretation of existing Article 9(2)(e))**

The European Court of Justice (ECJ) has consistently held that Article 9(2) sets out a number of specific instances of places where certain services are deemed to be supplied, whereas Article 9(1) lays down the general rule on the matter. In every situation, the question that arises is whether it is covered by a specific instance mentioned in Article 9(2). If not, it falls within the scope of Article 9(1)<sup>9</sup>

In effect, this has put a great deal of pressure on existing Article 9(2)(e), which lists services for which a customer that is a taxable person can account for VAT under the reverse charge

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<sup>9</sup> Case C-327/94 Dudda, paragraph 21.

mechanism. Services that arguably could be covered by such an Article include management fees, laboratory services (such as testing for conformity with technical specifications), product inspection including analysis and certification, interpreter services and translation services.<sup>10</sup>

The reality is that all new and all previously unknown services that do not fall within the scope of one of the exceptions are taxable where the supplier is established. This equally applies to services that are conducive to being supplied at a distance or at differing stages in the production chain. It can lead to cases of double taxation, unintentional non-taxation and often complicated and time consuming refund procedures under the Eighth or Thirteenth Directives.

#### **4.5. Composite Supplies**

The present rules do not adequately address composite or bundled services. Such services may consist of a number of different aspects, some which may be covered under existing Article 9(2)(e) and some that may not. Invariably an issue on how to characterise such a supply arises, as parties involved in such a transaction would seek to benefit from the reverse charge mechanism, rather than have the place of supply fall under the general rule. An example of such a supply would be that of waste disposal service which is a composite supply<sup>11</sup> involving a number of different operations in succession which are not covered under the existing Article 9(2)(c). The service only has some of the characteristics of services which consist of work on movable tangible property within the meaning of the fourth indent of Article 9(2)(c) and therefore falls under the general rule in Article 9(1).

### **5. SUMMARY OF THE PROPOSED RULES FOR TAXABLE PERSONS**

It has been concluded that it is necessary to consider a basic change to the place of supply of services rules for taxable persons. The main rule for services provided to taxable persons should be defined as “the place where the customer is established”. In the current provisions, both the place of establishment of the taxable person and the Member State where the customer is registered for VAT purposes are used to determine the place of supply of services. It is preferable to rely on the place where the customer is established as it covers all taxable and exempt activities. This is proposed as the general rule while simultaneously maintaining a number of exceptions, largely based on existing criteria. This ensures the general principle of taxation at the place of consumption, while guaranteeing the practicalities of the system by not imposing disproportional administrative burdens upon certain traders.

The effect of such a change would be twofold. First, it would limit the instances whereby a supplier would be required to register for VAT purposes when performing services in a Member State other than where he is established. Second, it would increase the reliance on the reverse charge mechanism (i.e., self-assessment) where a taxable person receives services from a person not established in the same country. Both of these effects can be regarded as major simplifications.

It would still be necessary to utilise certain exceptions to this general rule for both administrative and policy reasons, as previously mentioned. The identified exceptions are as follows:

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<sup>10</sup> Indeed, such services are routinely discussed at the VAT Committee where common interpretations of their tax treatment are sought.

<sup>11</sup> Case C-429/97 Commission vs. French republic

The first exception would need to be in respect of services connected with immovable property. This would be essentially the same as existing Article 9(2)(a) of the Sixth VAT Directive. The existing rule is reasonably straightforward to apply and generally results in taxation where the service is consumed. Additionally, this sector is often subject to exemptions, which in turn affect rights of deduction.

The second exception would need to be with respect to passenger transportation services. It would be very difficult to address this issue for taxable persons only and any change in this regard could result in difficult interpretative and administrative problems. The Commission recognises that the existing provisions cause problems and therefore proposes to address this issue in its subsequent evaluation of B2C supplies.

The third exception would need to be with respect to cultural, artistic, sporting, entertainment or similar services. Again, the existing rule, which is based on where these services are performed, generally results in taxation where consumption occurs.<sup>12</sup> It is proposed that scientific and educational services, when provided to taxable persons, be eliminated from this exception, largely for simplification purposes. For businesses that acquire such services in Member States other than where they are established, they would no longer be required to rely on the 8<sup>th</sup> Directive refund mechanism.

The final exception would need to relate to certain services that are tangible in nature, such as restaurant services. This ensures that services that are supplied for immediate consumption at a readily identifiable location are subject to VAT where the supplier is established. This exception would reflect the reality of where such services are, for all intents and purposes, consumed and would be easier for suppliers of such services to administer (e.g., they would not have to be concerned with whether their customer is a taxable or non-taxable person). Notwithstanding, this matter is difficult to address and this exclusion from the general rule would be monitored by the Commission and reviewed subsequently in conjunction with the rules for non-taxable persons (i.e., B2C).

## **6. THE EFFECT OF THE PROPOSED RULES ON THE AFOREMENTIONED PROBLEMS**

The proposed changes would, for the most part, resolve many of the aforementioned problems.

The general problem (Paragraph 4.1) of the misuse of Article 9(2)(e) would be resolved to a great extent as the place where the customer is established would become the general rule for establishing the place of supply.

The issue of hiring of means of transport (Paragraph 4.2) is fundamentally a problem of differing rules of deduction amongst Member States, which in turn creates inappropriate distortions. This problem would be avoided where the means of transport is hired or leased for period of time in excess of 30 days by virtue of the fact that with the place of taxation changing to where the customer is established, the reverse charge mechanism and local deduction rules would apply. Thus, the tax incentive to hire automobiles for long-term business use in other Member States would be eliminated. The short-term hiring or leasing of means of transport would continue to be where the supplier has established his business, thus better reflecting where consumption is likely to take place.

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<sup>12</sup> Existing Article 9(2)(c) of the Sixth VAT Directive

The issue of multiple registrations (Paragraph 4.3) would be resolved to a great extent as service providers would no longer ordinarily be required to register when performing services in other Member States. This problem is resultant largely from the existing exception in Article 9(2)(c) to the general rule. For example, it is proposed that service contracts involving work performed on tangible movable property would fall under the general rule.

The issue of relying on a list, such as the one in existing Article 9(2)(e), would be removed (Paragraph 4.4). As a result, the need to maintain or update the list as new appropriate services enter the market place or are identified would no longer be required. Further, issues of interpretation with regards to the services defined at present in the list would be removed. As the existing Article 9(2)(e) becomes, in effect, the new general default rule, all new services would automatically be captured.

Finally, on the issue of composite supplies (Paragraph 4.5), as the supply of services changes generally to the place where the customer is established and the reverse charge mechanism applies, any bundled or composite supplies would be simply be caught under the general rule. As such, the existing problem of the list of terms and reality of emerging business models (e.g., the service packages that include a variety of service elements) are less problematic.

## **7. EXTENSION OF THE VAT INFORMATION EXCHANGE SYSTEM (VIES) TO SERVICES**

The VIES was set up in 1993 to enable Member States to control exempt intra-Community acquisitions of goods by taxable persons. This information-exchange system was necessary, as with effect from 1 January 1993, there would no longer be documentary control of imports and exports at national frontiers. The reason that the VIES only covered intra-Community supplies of goods was that most of the rules on the place of taxation of services had not been changed by the advent of the single market.

Currently, the VIES supplies details of exempted intra-Community supplies of goods. Taxable persons making intra-Community supplies of goods on recapitulative statements (normally on a quarterly basis) supply the information to their national tax administrations. Each administration captures the data, and then transmits it electronically to the Member State of the taxable person making the intra-Community acquisition of the good, who can then verify if the reverse charge mechanism has been appropriately applied. It is also noteworthy that the messaging system is used for the exchange of information received from non-established taxable persons availing of the special scheme that was introduced by the E-Commerce VAT Directive adopted in May 2002, with effect 1 July 2003.<sup>13</sup>

From the perspective of tax administrations, systems and procedures are in place for the capture, storage, transmission and exploitation of the VIES data. Adding services to the scope of the VIES information would not impose a significant burden on administrations.

The Commission believes that a change to the place of supply rules of services warrants the inclusion of reverse charge services within the reporting obligations currently existing for intra-Community supplies of goods, which would imply an extension of the scope of the information exchanged between Member States through the VIES. In this regard, comments were sought on the question of extending VIES in the Commission's consultation paper that was published on 7 May 2003. In response, there was a general reaction against the extension, largely due to perceived additional administrative burdens and concerns over the systems'

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<sup>13</sup> Article 26c of the Sixth VAT Directive.

accuracy and effectiveness. In light of this, the Commission will review the technical functioning of the present system and investigate possible improvements that could make the system simpler, faster and more reliable. The review will commence in January 2004 and the extension of the reporting obligations to include services will only be implemented from January 2008 onwards. In advance of that date, the Commission will make a separate proposal to amend the regulation on administrative cooperation in the field of value added tax<sup>14</sup> in order to lay down the rules regarding the exchange of this information between Member States.

## **8. MEANING OF "FIXED ESTABLISHMENT"**

It has been suggested that the meaning of "fixed establishment" is problematic and should be clarified legislatively. This issue of the meaning of "fixed establishment" has been the subject of a number of court decisions. Essentially these decisions have concluded that an establishment must possess a sufficient degree of permanence and a structure adequate, in terms of human and technical resources, to supply the services in question on an independent basis. The Commission is of the view that the status quo is acceptable and a great many comments received in the public consultation concur.

It has also been suggested that where a taxable person makes a supply and has more than one establishment (e.g., a permanent establishment in one Member State and a fixed establishment in another Member State), that it may be ambiguous as to which establishment actually makes or receives the supply and that default criteria should be established. The Commission is of the view that which establishment makes a supply of a service is ultimately a question of fact and any introduction of criteria to be considered in making such a determination would not necessarily simplify matters. Again, the consultation responses largely reflected this opinion.

## **9. INTRA-COMPANY SERVICES**

It is the view of the Commission that supplies of services between different branches of a company or between a branch and its head office (i.e., different establishments) are normally outside the scope of VAT, provided that they are part of the same legal entity. This is the case where the establishments are situated within the same Member State or in more than one country. The Commission is aware that all Member States do not uniformly share this view. This results in uncertainty and the possible excessive application of VAT for suppliers of exempt services (e.g., financial services).

This issue was raised a number of times by respondents to the public consultation. Many respondents noted that this issue is problematic when dealing with cross-border transactions. The uncertainty regarding the rendering of intra-company services would be clarified by the introduction of a specific provision confirming the view that such services are not supplies for VAT purposes.

The Commission is also aware that in the exempt sector there is a potential for a bias towards the sourcing or performance of services in a Member State with a low VAT rate or in third countries. In effect, services for which no deduction would be available (e.g., for use as input in making an exempt supply) are acquired in the lowest-rate Member State or a third country before being passed on to branches existing in other higher rate Member States. This is only

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<sup>14</sup> Council Regulation (EC) No. 1798/2003 of 7 October 2003

an issue when the branch is situated in a different country as a ‘fiscal frontier’ exists. The Commission will continue to monitor the situation and, if necessary, address this problem when it brings forward proposals covering the various exempt sectors.

## **10. CONCLUSION**

Under the present place of supply rules, services are taxed on the basis of where the supplier is established unless they are specifically defined as being taxed somewhere else. In this regard, a number of exceptions to the general rule exist. However, as a result of globalisation and advances in technology as well as the nature of these supplies (e.g., intangible, composite, etc.) the addition of new appropriately defined exceptions is difficult. It is often the case that the issue of the place of supply of services is one determined by the Courts. Ultimately, this model is proving difficult to apply for taxpayers and difficult to administer for tax authorities.

In response, a shift from taxation where the supplier is established to taxation where the client is established would better reflect the current state of the services sector and provide greater certainty for all stakeholders. Exceptions to this general rule would still be required, but these services are clearly linked to special features that make the determination of the place of taxation administratively straightforward (e.g., the location of the immovable property) and better reflect the place of actual consumption (e.g., attending a sporting event).

## **11. COMMENTS REGARDING THE INDIVIDUAL PROVISIONS**

The legislative structure for the new proposed Article 9 would largely follow the structure of the existing provision. Article 9 itself would provide the general place of supply rule for both taxable and non-taxable persons. This would be followed by a series of exceptions, which may apply to taxable persons, non-taxable persons or both. In absence of a specific exception applying, the general place of supply rule found in Article 9 would apply.

### **Article 1(1)**

#### Article 6(6): Intra-Company Transactions

This provision confirms the Commission's view and that of a great majority of Member States. Where services are rendered within the same legal entity (e.g., a service rendered by a head office to branch), they are not considered to be supplies for purposes of the Sixth VAT Directive. This is the case where the establishments are within a single Member State or multiple countries. Services rendered for consideration between separate legal entities (e.g., head office and a wholly owned subsidiary) are supplies.

### **Article 1(2)**

#### Article 9: General Rule

##### Point (1):

The new general rule with respect to the place of supply of services to taxable persons would be determined on the basis of where the taxable person receiving the service is established, rather than the jurisdiction in which the supplier of the services is established. The taxable person receiving the supply would therefore rely on the reverse charge mechanism for supplies made by persons established in different countries. The long-term hiring and leasing

of vehicles would fall under the general rule as would most supplies of services by intermediaries.

#### Point (2)

The rules for non-taxable persons remain unchanged. The general rule with respect to the place of supply of such services would continue to be determined on the basis of where the supplier is established. [C.f. the existing Article 9(1)]

#### Point (3):

This provision addresses the issue of persons who for the purposes of the Sixth VAT Directive perform both economic (taxable and/or exempt) and out of scope activities. In the interest of administrative simplification and greater certainty for all parties concerned, these persons would be treated as taxable persons for purposes of Article 9 with respect to their acquisitions of services. As a result, even where a particular service may be for use as an input in their capacity as a non-taxable person, they would be treated as a taxable person with regards to the determination of the place of taxation for the services they acquire. The same would, of course, also apply for an exempt taxable activity. Ultimately, the person would be required to use the reverse charge mechanism to account for VAT applicable to the input, but no right of deduction would exist.

#### Article 9a: Immovable Property

The exception from the general rule relating to supplies of services related to immovable property applies equally to both taxable and non-taxable persons. The text remains virtually unchanged but does include the text “the provision of hotel or similar accommodation” and “the granting of rights to use immovable property” in order to give certainty that hotel services and access to toll roads are considered connected to immovable property. [C.f. the existing Article 9(2)(a)]

#### Article 9b: Passenger Transport

This exception from the general rule covers passenger transport services and applies equally to both taxable and non-taxable customers. The rules for taxation of passenger transport services have not been changed. Services of transporting goods for taxable persons are covered by the general rules, whereas services for transporting goods for non-taxable persons are covered under Article 9e. [C.f. the existing article 9(2)(b)] As noted previously, these rules would be addressed in the subsequent evaluation of B2C supplies.

#### Article 9c: Cultural, artistic, sporting, entertainment and similar activities

This exception from the general rule applies to cultural, artistic, sporting, entertainment and similar activities. This applies equally to both taxable and non-taxable customers. The text remains virtually unchanged from the existing Article 9(2)(c), first indent, but no longer includes a reference to scientific and educational services with respect to taxable persons. This would result in the taxable person being required to use the reverse charge mechanism rather than pay VAT and request a refund under the Eighth or Thirteenth Directive. For scientific and educational services supplied to non-taxable persons Article 9f applies.

#### Article 9d: Specific Services to Taxable Persons

A final exception from the general rule applies to the place of supply of what can be described as tangible services when supplied to a taxable person. The effect of this exception is to ensure that services that are supplied for immediate consumption at a readily identifiable location (e.g., restaurant meals and haircuts) are treated as being supplied at the place of origin. This rule better reflects the reality of where such services are consumed and is easier for suppliers of such services to administer.

The exception has three components. The first component requires that the service be rendered in the Member State where the supplier is established or has a fixed establishment. The second component requires the physical presence of both the service provider and the customer. The third component is that the services must be provided directly to an individual for immediate consumption, reflecting the nature of these services.

The long-term hiring or leasing of movable tangible property (e.g., the long term leasing of automobiles) and work on movable property (e.g., the repair of an automobile) are expressly excluded and such supplies would fall under the general rule.

'Long-term hiring or leasing' is defined to mean an agreement that provides continuous possession or use of movable tangible property for a period of more than 30 days. For example, where a taxable person hires an automobile at an airport for business use for a period of five days, the place of supply would be where the supplier is established, not where the business customer is established. This rule better reflects where the movable tangible property is going to be consumed and provides administrative ease for suppliers.

As noted previously, the operation of this provision would be monitored by the Commission and reviewed subsequently in conjunction with the rules for non-taxable persons (i.e., B2C).

#### Article 9e: Transport of Goods for Non-Taxable Persons

For taxable persons all transport of goods and all services ancillary to this transport would follow the general rule under new Article 9. As a result Article 28b(C) and (D) are deleted. The rules for non-taxable persons have been consolidated. In this regard, the provision is a merger of the existing Article 9(2)(b), Article 28b(C)(1), Article 28b(C)(4) and a part of Article 28b(E)(1). For all transport services the place of supply shall be the place of departure. This would change the place of supply for transport of imported and exported goods for non-taxable persons. This, however, would have little impact because the latter services are exempt under Article 14(1)(i) or Article 15(13). Note that related services rendered by intermediaries acting in the name and for the account of non-taxable persons would also be the place of departure.

#### Article 9f: Specific Services to Non-taxable Persons

The rule for ancillary transport services, valuations of and work on movable tangible property and services relating to scientific and educational activities when supplied to non-taxable persons would remain unchanged. The provision of these services would continue to be taxable at the place where the services are physically carried out. This provision incorporates the second, third and fourth indents of existing Article 9(2)(c).

#### Article 9g: Electronically Supplied Services to Non-taxable Persons

The place of supply of electronically supplied services, such as those described in Annex L, supplied to non-taxable persons by non-EU suppliers would continue to be the place where the non-taxable person is established, has his domicile or habitual residence. Non-EU suppliers of such services are required to collect VAT, which is ultimately remitted to the Member State where the non-taxable person is established.

As set out in Article 4 of Council Directive 2002/38/EC<sup>15</sup> of 7 May 2002 this rule applies for a period of three years starting from 1 July 2003.

#### Article 9h: Telecom and Radio and Television Broadcasting Services to Non-taxable Persons

The place of supply of telecommunications services and radio and television broadcasting services to non-taxable persons by non-EU suppliers would continue to be the place where the services are actually used and enjoyed. The article also includes the definition of 'telecommunication services'.

#### Article 9i: Intermediary Services to Non-taxable Persons

The place of supply of services rendered by intermediaries acting in the name and for the account of other persons, where such services form part of the transaction, would be the place where those transactions take place. This Article would not apply to those services referred to in Article 9e and Article 9j.

#### Article 9j: Services to Non-taxable Persons Outside the Community

This rule reflects that for non-taxable persons who reside outside the community, the place of supply rules for a specific list of intangible services would be the place where the person is established or has his permanent address or usually resides. The list of services largely mirrors what is at present in Article 9(2)(e).

#### Article 9k: Use and Enjoyment Override

This rule enables a Member State to override any of the place of supply rules that apply if there is a need to avoid double or non-taxation or address distortions of competition. The two deeming rules that are available to Member States under this provision mirror the existing rules under Article 9(3). At present, these rules only have limited application to supplies governed by the current Article 9(2)(e). It is proposed that these rules apply to the entire place of supply provisions, including both taxable and non-taxable persons.

### **Article 1(3)**

#### Article 12(3)(a) fourth subparagraph: Rates

The change in this Article is necessary because the corresponding paragraph of Article 9 has been renumbered.

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<sup>15</sup> Council Directive amending temporarily Directive 77/388/EEC as regards the value added tax arrangements applicable to radio and television broadcasting services and certain electronically supplied services

## **Article 1(4)(a)**

### Article 21(1)(b): Reverse Charge Mechanism

This rule would be changed as a result of the change to the place of supply rules for taxable persons. At present the reverse charge mechanism applies where a taxable person acquires a service listed in Article 9(2)(e) from a taxable person established in another country. The change to this provision would reflect the new provision, specifically the first sentence of Article 9(1).

## **Article 1(4)(b)**

### Article 21(5): Multiple Establishments and the Reverse Charge Mechanism

A new Article 21(5) is inserted in order to treat an establishment of a taxable person situated in another country who is also established within the territory of the country of the customer as a non-established taxable person. It has emerged from discussions in the VAT Committee that the reverse charge mechanism does not legally apply in this situation, although the situation is analogous to that of a non-established taxable person. This measure provides certainty as to which party is required to account for the VAT.

## **Article 1(5)**

### Article 22(6)(b): Extension of the VIES to Services

Existing Article 22(6)(b) would be replaced with effect from 1 January 2008. This allows the Commission reasonable time to review and improve the existing VIES such that it can be extended to services. As a result, from this date onwards suppliers of services to taxable persons (i.e., customers), who are required to account for the VAT under the reverse charge mechanism, would be required to include services on their recapitulative statement. The information required to be reported would be the supplier's VAT identification number, the customer's VAT identification number and the total value of the supplies of services provided by the supplier to each taxable customer.

## **Article 1(6)**

### Article 28b(C), (D), (E) and (F): Deletion of Specific Services Rules

Under the proposal, it would be necessary to delete the provisions contained in Articles 28b(C), (D), (E) and (F). Depending on the particular provision, it has either been rendered unnecessary or reproduced in another form under the guise of administrative streamlining.

### Article 28b(C)

The intra-Community transport of goods for taxable persons would now be caught under the general rule for services to taxable persons found in Article 9(1). For non-taxable persons, this rule is reproduced in proposed Article 9e.

### Article 28b(D)

Services ancillary to intra-Community transport of goods for taxable persons would be caught under the general rule for services to taxable persons found in Article 9(1). For non-taxable persons, this rule is reproduced in proposed Article 9f(a).

#### Article 28b(E)

The place of supply for services performed by intermediaries for taxable persons would be caught under the general rule for services to taxable persons found in Article 9(1). This applies for both services related to the transportation of goods and of passengers. For non-taxable persons, the supply for services performed by intermediaries related to transportation would be the place of departure, as per Article 9(e). In all other circumstances, the place of supply of intermediary services for non-taxable persons is where those services are performed.

#### Article 28b(F)

The place of supply of valuation of and work on movable tangible property when provided to taxable persons would also be caught under the general rule for services to taxable persons found in Article 9(1). For non-taxable persons, this rule is reproduced in Article 9f(b).

Proposal for a

**COUNCIL DIRECTIVE**

**amending Directive 77/388/EEC as regards the place of supply of services**

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 93 thereof,

Having regard to the proposal from the Commission<sup>16</sup>,

Having regard to the opinion of the European Parliament<sup>17</sup>,

Having regard to the opinion of the European Economic and Social Committee<sup>18</sup>,

Whereas:

- (1) The realisation of the internal market, globalisation, deregulation and technology change have all combined to create enormous changes in the volume and pattern of trade in services. It is increasingly possible for a number of services to be supplied at a distance. In response, piece-meal steps have been taken to address this over the years and many defined services are in fact at present taxed on the basis of the destination principle.
- (2) The proper functioning of the internal market requires the amendment of the Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment<sup>19</sup> as regards the place of supply of services, following the Commission's strategy of modernisation and simplification of the operation of the VAT common system<sup>20</sup>.
- (3) For all supplies of services the place of taxation should, in principle, be the place where the actual consumption takes place. If the general rule for the place of supply of services rules were to be altered in this way, it would still be necessary to utilise certain exceptions to this general rule for both administrative and policy reasons.

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<sup>16</sup> OJ C , , p. .

<sup>17</sup> OJ C , , p. .

<sup>18</sup> OJ C , , p. .

<sup>19</sup> OJ L 145, 13.6.1977, p. 1. Directive as last amended by Directive 2003/92/EC (OJ L 260, 11.10.2003, p. 8).

<sup>20</sup> COM(2000) 348 final

- (4) For supplies of services to taxable persons, the general rule with respect to the place of supply of services should be based on the place where the customer is established, rather than where the supplier is established.
- (5) Where services are supplied to non-taxable persons, the general rule should continue to be that the place of supply of services is the place where the supplier has established his business.
- (6) In certain circumstances, the general rules as regards the place of supply of services for both taxable and non-taxable persons are not applicable and specified exclusions apply. These exclusions should be largely based on existing criteria and reflect the principle of taxation at the place of consumption, while not imposing disproportionate administrative burdens upon certain traders.
- (7) Where a taxable person receives services from a person not established in the same Member State the reverse charge mechanism should be obligatory, meaning that the taxable person should self-assess the appropriate amount of VAT on the acquired service.
- (8) Services rendered between different establishments of a taxable person are normally outside the scope of Directive 77/388/EEC. In the interests of greater legal certainty, that position should be confirmed in legislation.
- (9) Directive 77/388/EEC should therefore be amended accordingly,

HAS ADOPTED THIS DIRECTIVE:

#### *Article 1*

Directive 77/388/EEC is hereby amended as follows:

- (1) In Article 6 the following paragraph 6 is inserted:

“Where a single legal entity has more than one fixed establishment, services rendered between the establishments shall not be treated as supplies.”

- (2) Article 9 is replaced by the following:

#### *"Article 9*

##### **General rule**

1. The place of supply of services to taxable persons shall be the place where the customer has established his business or has a fixed establishment to which the service is supplied.

If the place where a taxable person has established his business or where he has a fixed establishment can not be determined, the place of supply of services shall be the place where that taxable person has his permanent address or usually resides.

2. The place of supply of services to non-taxable persons shall be the place where the supplier has established his business or has a fixed establishment from which the service is supplied.
3. For the purposes of paragraphs 1 and 2, where a person is a taxable person who also performs activities or transactions that are not considered to be taxable supplies of goods or services, he shall be deemed to be a taxable person in respect of all services supplied to him except where the services are for his own private use or that of his staff.

*Article 9a*

**Immovable property**

The place of supply of services related to immovable property, including the services of estate agents and experts, the provision of hotel or similar accommodation, the granting of rights to use immovable property and services to prepare and co-ordinate construction work, such as the services of architects and of firms providing on-site supervision, shall be the place where the immovable property is located.

*Article 9b*

**Passenger transport**

The place of supply of passenger transport services shall be the place where the transport is effected, proportionate to the distances covered.

*Article 9c*

**Cultural, artistic, sporting, entertainment and similar activities**

The place of supply of services relating to cultural, artistic, sporting, entertainment, or similar activities, including the activities of the organisers of such activities, and where appropriate, the supply of services ancillary to such activities, shall be the place where those services are physically carried out.

*Article 9d*

**Specific services to taxable persons**

The place of supply of services to taxable persons, other than the long-term hiring or leasing of or working on movable tangible property, shall be the place where the supplier has established his business or has a fixed establishment from which the service is supplied, or the place where he has a permanent address or usually resides, when the following conditions are met:

- (a) the services are rendered in the Member State in which the supplier is established, has a fixed establishment, or has a permanent address or usually resides,

- (b) the services require the physical presence of the service provider, or the material presence of the means of providing the service, at the same time as the physical presence of the customer,
- (c) the services are provided directly to an individual for immediate consumption.

For purposes of this Article, 'long-term hiring or leasing' shall mean an arrangement governed by an agreement providing for continuous possession or use of the movable tangible property throughout a period of more than thirty days.

#### *Article 9e*

#### **Transport of goods for non-taxable persons**

1. The place of supply of transport services of goods, including intra-Community transport and the services of intermediaries, to non-taxable persons shall be the place of departure.
2. Member States need not apply the tax to that part of the intra-Community transport of goods corresponding to journeys made over waters which do not form part of the territory of the Community.
3. 'Intra-Community transport of goods' shall mean transport of goods where the place of departure and the place of arrival are situated within the territories of two different Member States.
4. The transport of goods where the place of departure and the place of arrival are situated within the territory of the same Member State shall be treated as intra-Community transport of goods where such transport is directly linked to the transport of goods where the place of departure and the place of arrival are situated within the territories of two different Member States.
5. The 'place of departure' shall mean the place where the transport of goods actually starts, irrespective of distances covered to the place where the goods are located and the 'place of arrival' shall mean the place where the transport of goods actually ends.

#### *Article 9f*

#### **Specific services to non-taxable persons**

The place of supply of the following services supplied to non-taxable persons shall be the place where those services are physically carried out:

- (a) ancillary transport activities such as loading, unloading, handling and similar activities in the name and on behalf of other persons;
- (b) valuations of and work on movable tangible property;
- (c) services relating to scientific and educational activities, including the activities of the organisers of such activities and, where appropriate, the supply of ancillary services.

### *Article 9g*

#### **Electronically supplied services to non-taxable persons**

Until 30 June 2006, the place of supply to non-taxable persons of electronically supplied services, including in particular the services referred to in Annex L and services supplied by a taxable person who has established his business outside the Community or has a fixed establishment there from which the service is supplied, shall be the place where the non-taxable person is established, has his permanent address or usually resides.

### *Article 9h*

#### **Telecom services and radio and television broadcasting services to non-taxable persons**

The place of supply of telecommunications services, including the provision of access to global information networks, and radio and television broadcasting services, supplied to non-taxable persons by a taxable person who has established his business or has a fixed establishment from which the service is supplied outside the Community shall be the country in which the services are effectively used and enjoyed.

For purposes of this Article, ‘telecommunications services’ shall mean services relating to the transmission, emission or reception of signals, words, images and sounds or information of any nature by wire, radio, optical or other electromagnetic systems, including the related transfer or assignment of the right to use capacity for such transmission, emission or reception.

### *Article 9i*

#### **Services supplied by intermediaries to non-taxable persons**

The place of supply of services rendered to non-taxable persons by intermediaries acting in the name and on behalf of other persons shall, where such services form part of transactions other than those referred to in Article 9e and Article 9j, be the place where those transactions are carried out.

### *Article 9j*

#### **Services to non-taxable persons outside the Community**

The place of supply of the following services supplied to a non-taxable person who is established or who has his permanent address or usual residence outside the Community shall be the place where that person is established, has his permanent address or usually resides:

- (a) transfers and assignments of copyrights, patents, licences, trade marks and similar rights;
- (b) advertising services;
- (c) the services of consultants, engineers, consultancy firms, lawyers, accountants and other similar services, as well as data processing and the provision of information;

- (d) obligations to refrain from pursuing or exercising, in whole or in part, a business activity or a right referred to in this Article;
- (e) banking, financial and insurance transactions including reinsurance, with the exception of the hire of safes;
- (f) the supply of staff;
- (g) the hiring out of movable tangible property, with the exception of all means of transport and of all other vehicles;
- (h) telecommunications services, including the provision of access to global information networks;
- (i) the provision of access to, and of transport or transmission through, natural gas and electricity distribution systems and the provision of other directly linked services;
- (j) radio and television broadcasting services;
- (k) electronically supplied services, in particular, those referred to in Annex L;
- (l) the services of agents who act in the name and on behalf of other persons, when they procure for their principal the services referred to in this Article.

#### *Article 9k*

#### **Avoidance of double taxation**

In order to avoid double taxation, non-taxation or distortion of competition Member States may, with regard to the supply of services referred to in Article 9, Article 9a, Article 9b, Article 9c, Article 9d, Article 9e, Article 9f, Article 9h, Article 9i and Article 9j, treat:

- (a) the place of supply of services, if situated within their territory, as being situated outside the Community where the effective use and enjoyment of the services actually takes place outside the Community;
  - (b) the place of supply of services, if situated outside the Community, as being situated within their territory where the effective use and enjoyment of the services actually takes place within their territory.”;
- (3) In Article 12(3)(a), the fourth subparagraph, is replaced by the following:
- “The third subparagraph shall not apply to the services referred to in Article 9j(k).”
- (4) Article 21, in the version set out in Article 28g, is amended as follows:
- (a) in paragraph 1, point(b) is replaced by the following:
    - “(b) taxable persons to whom services covered by Article 9(1) are supplied if the services are carried out by a taxable person not established within the territory of the country;”

(b) the following paragraph 5 is added:

"In cases where the taxable transaction is made by an establishment of a taxable person which is not situated in the territory of the country, where that person has at the same time an establishment in the same Member State as the customer, the taxable person shall be deemed, for the purposes of paragraphs 1 and 2, not to be established within the territory of the country."

(5) Article 22(6)(b), in the version set out in Article 28h of Directive 77/388/EEC shall be amended as follows:

(a) The first subparagraph is replaced by the following:

"Every taxable person identified for value added tax purposes shall also submit a recapitulative statement of the acquirers identified for value added tax purposes to whom he has supplied goods under the conditions provided for in Article 28c (A) (a) and (d), and of consignees identified for value added tax purposes in the transactions referred to in the fifth subparagraph and of the taxable customers to whom he has supplied services under the conditions provided for in Article 9(1)".

(b) The third subparagraph is replaced by the following:

"The recapitulative statement shall set out:

- the number by which the taxable person is identified for purposes of value added tax in the territory of the country and under which he effected supplies of goods in accordance with the conditions laid down in Article 28c (A) (a) and under which he effected supplies of services in the conditions laid down in Article 9(1),
- the number by which each person acquiring goods or services is identified for purposes of value added tax in another Member State and under which the goods or services were supplied to him,
- for each person acquiring goods or services, the total value of the supplies of goods or services effected by the taxable person. Those amounts shall be declared for the calendar quarter during which the tax became chargeable."

(c) The following sixth subparagraph is added:

"As regards services, the provisions of the first and third subparagraphs shall apply from 1 January 2008."

(6) Articles 28b(C), (D), (E) and (F) are deleted.

## *Article 2*

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by ##### at the latest. They shall forthwith communicate to the Commission the text of those provisions and a correlation table between those provisions and this Directive.

When Member States adopt those provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. Member States shall determine how such reference is to be made.

2. Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.

*Article 3*

This Directive shall enter into force on the day following that of its publication in the *Official Journal of the European Union*.

*Article 4*

This Directive is addressed to the Member States.

Done at Brussels,

*For the Council  
The President*

## **IMPACT OF THE PROPOSAL ON BUSINESS WITH SPECIAL REFERENCE TO SMALL AND MEDIUM-SIZED ENTERPRISES (SMEs)**

### **TITLE OF PROPOSAL**

Proposal for a Council Directive amending Directive 77/388/EEC as regards the place of supply of services.

### **THE PROPOSAL**

1. Taking account of the principle of subsidiarity, why is Community legislation necessary in this area and what are its main aims?

The Commission considers that any modification of the rules governing the place of taxation of services should respect, as far as possible, that for all services the place of taxation should, in principle, be the place where the actual consumption takes place.

For supplies of services to taxable persons, **the general rule with respect to the place of supply of services** should be based on **where the customer (i.e., the taxable person) is established**, rather than where the supplier is established. The advantages of this approach are many. First, there would be no need to amend the Sixth Directive with respect to taxable persons every time a new service or service delivery model appears. Second, this approach is more in line with the one used in many other VAT jurisdictions. This would diminish the possibilities of double or unintentional non-taxation in international supplies of services. Finally, it resolves a number of bundling issues, such as those that might exist between tangible and intangible services.

Furthermore, any new proposal on the place of supply of services should seek a balance between the control needs for tax administrations and the administrative obligations for traders.

### **THE IMPACT ON BUSINESS**

2. Who will be affected by the proposal?

Which sectors of business?

All sectors of business are concerned, both as suppliers of services and as persons receiving services supplied by taxable persons established in other countries.

Which size of business (what is the concentration of small and medium-sized firms)?

All sizes of business.

3. What will business have to do to comply with the proposal?

Nothing in particular. Businesses must comply with national legislation introduced by their Member State to amend, where appropriate, the applicable rules in order to transpose the Directive.

4. What economic effects is the proposal likely to have:

On employment?

On investment and the creation of new businesses?

On the competitiveness of businesses?

On consumers?

This proposal as such will have no direct impact on employment, consumers and investments. Because this proposal introduces some major simplifications such as an increased reliance on the reverse charge mechanism the competitiveness of business will improve.

5. Does the proposal contain measures to take account of the specific situation of small and medium-sized firms (reduced for different requirements, etc.)?

No

#### **CONSULTATION**

6. On 7 May 2003 DG TAXUD launched an on-line consultation at the TAXUD web-site. The consultation period officially ended on 30 June 2003 but responses were still received and informally accepted until the middle of August.

A total of 57 external contributions were received in response to the consultation. Of that total, 33 were from national and European federations or associations, 22 were from business and two were from individuals.

While the overwhelming majority of respondents are supportive of the proposed framework for the rules that envisions a change from the origin principle to the destination principle with respect to the place of taxation of services supplied to taxable persons, there were a few persons who called for the continuation of the origin system, albeit enhanced by the introduction of a structure to redistribute VAT back to the Member State where the customer is established. Additionally, those who were supportive of the change from origin to destination had a number of concerns with respect to the outlined exclusions from the proposed general.

Of those who expressed their view on the extension of VIES, a large majority strongly opposed the idea. VIES as it is functioning nowadays is seen as a source of practical difficulties, of errors and of costs. It is generally not considered to be an efficient tool to combat fraud. It was also noted several times that VIES only covers services supplied by a taxable person in one of the Member States.

A synopsis of the responses and a list of the responders were published on the web-site on 18 September 2003.

#### **IMPACT ON MEMBER STATES**

7. The proposed amendments will not have any impact on own resources.