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**Summary**

The Commission has published a Consultation Paper concerning *VAT – The Place of Supply of Services*, which suggests that the "default" provision should no longer be taxation on the basis of where the *supplier* is established, but taxation where the *customer* is established. This Briefing examines the general problems of levying VAT on services within the Single Market, and makes a number of comments on the Commission paper.

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VAT ON SERVICES

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Introduction

One of the theoretical advantages of VAT over sales or purchase taxes is that it can be applied equally and neutrally to both goods and services. As products weave their way through the complexities of a modern economy towards final consumption, every input – whether it is a physical good or an intangible service – is taxed, and taxed only once.

Yet levying VAT on services, particularly within the context of cross-frontier transactions, has always been a source of trouble. As the seventh recital to the Sixth VAT Directive observes:

"...the determination of the place where taxable transactions are effected has been the subject of conflicts concerning jurisdiction as between Member States, in particular as regards supplies of goods for assembly and the supply of services;..."

Such problems are reflected in the Directive itself. Article 9 states with apparent clarity that

"the place where a service is supplied shall be deemed to be the place where the supplier has established his business or has a fixed establishment from which the service is supplied..."

VAT should in consequence always be charged at the rate prevailing in that country of establishment and accrue to that country's Treasury.

Article 9, however, then continues with a long list of derogations and exceptions. In the case of work on buildings, the place of supply is where the building is located (Article 9.2.a). In the case of transport, it is where the journey takes place (Article 9.2.b). In other cases the place of supply is where the service is carried out (Article 9.2.c); in others, if the customer is VAT-registered in another Member State, where that customer is established (Article 9.2.e and the seventh recital).

The effect of this, as the Commission has noted,

"is to reduce the scope of the principle of taxation in the place where the supplier is established to the point where its application is marginal." \(^1\)

Instead, there is extreme complexity. The provisions on services contribute to the fact that there are some 25 rules for determining the place of taxable transactions, which are also interpreted differently in various Member States\(^2\). The complexity of the provisions, moreover, has given rise over the years to a large number of legal disputes, many of which have needed to be resolved by the European Court of Justice. The most recent judgement (see Annex 2), for example, has concerned

"advertising services supplied indirectly to the advertiser and invoiced to an intermediate customer who in turn invoices them to the advertiser."

* 

In June 2000 the Commission published a Communication on a Strategy to Improve the Operation of the VAT System within the Context of the Internal Market (COM(2000)348), outlining a new list of priorities and a timetable. A further Communication on Tax Policy in the European Union – priorities for the years ahead was published in May 2001 (COM(2001)260). In this, the Commission stated its intention to publish additional VAT

\(^1\) COM(94)471, p.9

proposals and listed some "potential future priorities". Among these was "the place of taxation of services: general revision".

In May 2003 the Commission accordingly published a Consultation Paper, *VAT – The Place of Supply of Services*\(^3\), and asked for comments on proposals to rewrite Article 9. For the moment, the Commission concentrates only on "business-to-business" (B2B) transactions (i.e. between VAT-registered traders), but with the intention of consulting later on "business-to-consumer" (B2C) transactions (i.e. supplies to non-taxable persons).

In essence, the Commission suggests that the "default" provision should no longer be taxation on the basis of where the *supplier* is established, but taxation where the *customer* is established.

\(^3\) TAXUD/C3/.
Background

Changes in the Service sector

For over a century the services sectors of developed economies have been steadily growing both in size and variety. The switch away from agriculture and industry has meant that services now account for between half and three-quarters of all employment in EU Member States.

Most traditional service industries – shops, schools and hospitals, construction, public administration, etc. – have operated largely within narrowly-defined geographical areas. This has meant that cross-frontier transactions have been limited, and VAT has been levied within single VAT jurisdictions.

Over recent years, however, the pattern has steadily changed in two ways.

- The European Single Market, together with a similar opening up of international commerce, has meant increasing supplies of services across frontiers – most obviously in the case of those traditional service industries, like transport and tourism, which have by their nature been an exception to geographical limitations.

- To these traditional industries have now been added, as a result of technological advance, whole new service sectors, notably those based on information technology and intellectual property. Where in the case of more traditional services like shoe repairing or hairdressing there has been a physical activity which can define the location of the supply, in the case of such new services – for example, the transfer of data electronically – it has become difficult to define whether, when and where any activity has taken place.

VAT: the origin and destination principles

Value Added Tax developed originally as a tax on business turnover. As such, the place of taxation was clear-cut: where the business supplying the goods or services was located for tax purposes. In a cross-frontier context this implied full application of the "origin" principle: the revenue at each stage in a chain of transactions would accrue to the country where that transaction took place: i.e. where the value was added.

By the time VAT was adopted by the European Community, however, it was generally seen as a general consumption tax, replacing various forms of sales tax. This implied general application of the "destination" principle: all the revenue from every stage of the transaction should accrue to the country of final consumption. This has been the effect in the case of commercial transactions of the "transitional" VAT system established within the EU Single Market in 1993. It is also worth noting that it would also have been the effect of the system proposed by the Commission in 1987, based on the "origin" principle, but with the clearing of revenues to the countries of destination.

There have, indeed, been few proposals for the uniform application of either a pure origin, or a pure destination system. In the case of the transitional system, for example, a distinction is made between commercial transactions on the one hand – where application of the pure origin system would allow traders to deduct in one country the VAT paid in another – and sales to final consumers on the other. The theoretical options are shown in Table 1.
### Table 1: Theoretical VAT systems

<table>
<thead>
<tr>
<th>System</th>
<th>Tax rate</th>
<th>Who gets the revenue</th>
<th>Mechanisms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pure origin</td>
<td>Country of origin</td>
<td>Country of origin</td>
<td>As within any single Member State (i.e. VAT always charged on invoice).</td>
</tr>
</tbody>
</table>
| Origin with clearing          | Country of origin         |                                    | • In the case of "business-to-business" (B2B) transactions, country of destination.  
• In the case of "business-to-consumer" (B2C) transactions, country of origin.  
• As within any single Member State.  
• But revenues from B2B transactions remitted to country of destination. |
| Mixed system (e.g. "transition al" system currently in operation in EU) | • In the case of B2B transactions, country of destination.  
• In the case of most B2C transactions\(^4\), country of origin. | • In the case of B2B transactions, country of destination.  
• In the case of most B2C transactions, country of origin. | • Supplies to another Member State invoiced at zero rate, or reverse charge mechanism (i.e. customer liable for VAT).  
• Purchases by a final consumer in any Member State in principle in free circulation within EU, subject to "special regimes" (see footnote). |
| Pure destination              | All transactions, country of destination. | All transactions, country of destination. | • In the case of B2B, reverse charge mechanism; or detaxing/retaxing at frontiers (e.g. pre-1993).  
• In the case of B2C, seller liable for VAT, but revenues cleared to country of destination (e.g. e-commerce Regulation); or travellers' VAT remitted/collected, at frontiers (e.g. pre 1993). |

\(^4\) "Special regimes" for distance sales; cars, boats and planes; and exempt bodies.
Levying VAT on services

Whatever the general principle applying to VAT, there are a number of practical options for determining the place of supply: i.e. the jurisdiction in which the VAT becomes payable and hence the rate of tax and the national budget receiving the revenue. In the case of physical goods, the general rule laid down in Article 8 of the 6th Directive – that the place of supply is "where the goods are" at the time of the transaction – is more-or-less obvious.

In the case of services, however, the picture is less clear-cut. Article 6 of the comparatively short Second VAT Directive\(^5\) states that

\[
\text{The place of the provision of service shall, as a general rule, be regarded as the place where the services provided, the right transferred or granted, or the object hired, is used or enjoyed. The chargeable event shall occur at the moment when the service is provided.}
\]

The default was, however, only compulsorily applicable to services listed in an Annex B. Moreover, as the Commission consultation paper observes, it was recognised in discussions leading up to the 6th VAT Directive that systematic application of this rule could lead to "some serious practical problems". The default rule was accordingly changed by Article 9 of the 6th Directive to the supplier's place of establishment.

But this principle was also seen to raise problems, leading to the special paragraphs applying the original 2nd Directive rules to various services.

In addition, certain services were identified where neither the 2nd nor the 6th defaults appeared satisfactory. These were broadly professional services, supplied by lawyers, accountants, consultants, financial advisers, agencies, etc. to clients in another country. In such cases the place where the service was "used or enjoyed" could be difficult to determine; and, if the place of supply were to be the supplier's place of establishment, such services would have an incentive to locate in the Member State with the lowest VAT rates. In such cases a third option was chosen:

\[
\text{the place where the customer has established his business or has a fixed establishment to which the service is supplied, or, in the absence of such a place, the place where he has his permanent address or usually resides.}
\]

The same principle also needed to be applied, as stated in the seventh recital to the Directive,

\[
\text{in the case of certain services supplied between taxable persons where the cost of the services is included in the price of the goods.}
\]

This principle, in practical terms, gave rise to the "reverse charge" procedure, whereby the normal rules of VAT are broken: the purchaser, rather than the vendor, is liable to account for tax.

The telecommunications and e-commerce precedent

The problems raised by the default procedures of the 2nd and 6th VAT Directives were further exposed by rapid advances in telecommunications during the 1980s and 90s. Application of the "place of supply" rule made the purchase of telecommunications services

---


\(^6\) In cases when services lasting over a long period were provided, the event could, however, be the issuing of the invoice or receipt of payment.
from non-EU suppliers increasingly economic. The problem for national revenues came not so much from individual phone-users as from large VAT-exempt organisations, notably those involved in financial services. As important was the distortion of competition between EU-based suppliers, and those based outside.

In March 1997, forestalling Commission proposals for a Directive on the matter, the fifteen Member States simultaneously applied for and granted each other a derogation from the normal provisions of Article 9. The place of taxation for telecommunications services was switched from the supplier’s location to that of the purchaser, and the purchaser became liable for the tax. This system was eventually made permanent in preference to the Commission’s original alternative⁷ (to switch the place of taxation, but retain the collection of tax by the supplier and oblige non-EU suppliers to register for VAT in a Member State).

Telecommunications services, however, turned out to be only the tip of an iceberg. Advances in information technology have made it possible for customers to download certain products from sources which can be, effectively, anywhere in the world. In addition, the distinction between “goods” and “services” has become blurred: software or electronic documents, for example, are “goods” without physical form. It was quickly agreed that all such products should in principle be taxed as “services”.

The most serious problem, however, was the tax advantage given to non-EU based suppliers. Electronic goods downloaded from inside the EU were subject to VAT. Those supplied from outside were not. This gave US or Japanese firms an estimated average tax-related price advantage of between 15 and 20%. At the same time, EU-based suppliers to third countries had to charge VAT. The Commission at first proposed that non-EU suppliers should register in a single Member State, which would then have become the place of supply. This solution, however, ran into strong opposition in Council, where it was pointed out that non-EU suppliers would be likely to invoice from the Member State with the lowest VAT rates.

Negotiations eventually produced an agreement similar to that reached in the case of telecommunications. Non-EU suppliers need to register in one Member State only; in the case of cross-frontier transactions, the place of supply is in principle that of the customer; and revenues are to be remitted to the country of consumption by the country of registration through a "clearing" mechanism (as advocated by Parliament). The situation under the Directive⁸ is therefore as in Table 2.

### Table 2: VAT Rules under the E-Commerce Directive

<table>
<thead>
<tr>
<th></th>
<th>EU supplier</th>
<th>Non-EU supplier</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-EU business customer</td>
<td>No VAT</td>
<td>No VAT</td>
</tr>
<tr>
<td>Non-EU private individual</td>
<td>No VAT</td>
<td>No VAT</td>
</tr>
<tr>
<td>EU business customer</td>
<td>VAT in country of customer (reverse charge unless same country)</td>
<td>VAT in country of customer (reverse charge)</td>
</tr>
<tr>
<td>EU private individual</td>
<td>VAT in country of supplier.</td>
<td>Registration in country of consumer or &quot;identification&quot; in another EU country. VAT at rate of country of customer.</td>
</tr>
</tbody>
</table>

---

⁷ Proposal for a Council Directive…as regards the value added tax arrangements applicable to telecommunications services, COM(97)4.

**Administrative issues**

In the case of B2B sales, application of the reverse charge procedure raises no problem of revenue allocation. There are, however, certain problems of information exchange: sellers need to know whether customers are VAT-registered or not in order to issue correct invoices, and tax authorities need to know when a customer is due to account for VAT. The existing VIES system enables traders to verify the VAT numbers of their customers – but only, at present, in the case of the intra-Community trade in goods.

In the case of sales to final consumers and exempt bodies (B2C) third-country firms identified for VAT purposes in one Member State but selling into another must charge VAT at the rate prevailing in the customer's country. This settles the issue of tax rate; but leaves that of revenue allocation. Under the strict destination principle applying to e-commerce, the money is due to the country of consumption; but has been collected in the country of supply.

The e-commerce Regulation\(^9\) solves this through an automated electronic system reallocating the revenues collected to the Member State of consumption. Initially, the scheme will run for a trial period of three years, starting on 1 July 2003. Businesses must then submit quarterly VAT returns detailing supplies for each Member State of consumption where tax has become due. These must show the applicable rates and the total tax due.

Options for Change

In determining whether, and if so what, changes should be made to the present system for levying VAT on services, there is an important question préalable:

- Is the objective to institute a single principle which will apply to all supplies of services, or at least to all B2B transactions?

- Or is the objective only to re-define the general "default" system, with the continuation of special derogations and exceptions?

A uniform system

Applying a single principle to the taxation of services, without derogations or exceptions, and applying equally to B2B and B2C transactions, would clearly make the EU's VAT system a great deal simpler. The problems of definition which arise from the application of different principles to different services (especially complex when services in different categories are "bundled" in a single transaction) would disappear. There would be greater legal certainty.

Unfortunately, none of the three broad principles already outlined can easily be applied uniformly in the context of the current VAT system.

Place of consumption

Taxing all services on the basis of "where the benefit is enjoyed", as envisaged in the 2nd VAT Directive, could certainly continue to apply to the range of services currently listed as exceptions in the 6th Directive. It could probably apply equally well to a range of services currently subject to the "supplier's place of establishment" rule, but where the benefit is enjoyed at the same location (e.g. hairdressing). On the other hand, it would often be difficult to determine where exactly the benefits of the "professional" services listed in Article 9(2)e of the 6th Directive had actually taken place. Applying a version of the principle to transport ("the place where the transport takes place") under Article 9(2)b of the 6th Directive has proved effectively unworkable (see later section).

The Commission's consultation paper also draws attention to the problem of "services physically carried out on movable property", where the existing (exceptional) rule makes the basis of taxation where the service (e.g. repairs) are performed. A better basis, it argues, might be the place of establishment of the supplier or of the customer.

In any case, in the context of B2B transactions only, when two VAT-registered bodies are concerned, there are administrative advantages in making the place of supply where one or the other is established.

Place of supplier

Considerations such as these led to the general principle expressed in the 6th Directive. At the time, as the Commission's consultation document observes, this "to a very large degree...in fact resulted in the tax accruing to the country of consumption". But as it became increasingly possible for services to be supplied at a distance, "piece-meal steps have been taken to address this over the years", resulting in the various exceptions.

What would be the effect of simply eliminating these?

In the context of the present VAT system, the immediate problem would be to ensure application of the destination principle: i.e. to ensure that tax is paid at the rate of the country of consumption, and accrues to that country. Practically, this has in the past implied that the
suppliers of services should have an establishment, be registered for VAT, or have a VAT representative, in countries where they have customers.

Failing this, there would be an incentive for those services concerned which can be supplied at a distance to relocate in Member States with relatively low VAT rates. The revenues from the VAT levied would then accrue to those countries. In the case of entertainments, sporting events, repairs, etc., where the "place of consumption" rule currently applies, the firms concerned would also have incentives to operate out of low-tax locations.

The discussions which took place in the context of the e-commerce Directive gave a good indication of how any such move would be received by national governments. A single EU country of registration for non-EU suppliers was only accepted on the basis of the "country of customer" principle being applied not only in the case of B2B transactions, but also in that of B2C.

**Place of customer**

The solution to the problem of services supplied at a distance, incorporated into Article 9(2)e of the 6th Directive, has been to make such services supplied to a taxable person (i.e. B2B) taxable on the basis of where the customer is established. This makes it certain that the VAT rate charged is that of the customer's country, and that the revenue also accrues to that country.

A general application of this rule, however, could also have distorting effects. In the case of entertainments, etc., it would now be VAT-registered *customers* (e.g. the hirers of tents, sound equipment, etc.) who would have an incentive to relocate to low-tax countries. The same would be true of property companies managing sites in relatively high-tax jurisdictions. For this reason the Commission advocates a continuation of "place of consumption" rule in these cases. The Commission also notes a potential absurdity that could arise in the case of such services as restaurants and other services "that are tangible in nature": *restauranteurs* would have to ascertain whether a particular customer was VAT-registered; and, in that case, the VAT chargeable would be that of the customer's home country, with the revenue having to accrue there.

This leads to the related but separate question of how VAT based on the place where the customer is established should be accounted for. Under the present VAT system, the answer is the same as in the case of cross-frontier deliveries of goods: no VAT is levied by the supplier (i.e. the supply is invoiced at zero).

**A switch to origin**

The position would, however, change fundamentally were the promised "definitive" VAT system, based on the origin principle with clearing, to be introduced. In this case, virtually all B2B transactions in services could be taxed on the basis of the current default: i.e. the suppliers' place of establishment. There would still be certain B2B cash-flow advantages in locating in low-tax countries\(^{10}\); but net revenues would all accrue, *via* the clearing system, to the country of final consumption.

For example, a law firm based in, say, Luxembourg might supply services to a firm in Germany. The invoice would show VAT at 15% (rather than 0%), which the German client

\(^{10}\) But not, of course, if VAT rates were to be harmonised or approximated. This would also eliminate any advantage in B2C transactions.
would deduct as input tax. The revenue would not, however, remain in Luxembourg, but would be "cleared" to the German Finance Ministry.

This system, originally proposed for general application by the Commission in 1987, was not adopted by Member States in 1992 because of scepticism about the operation of clearing. Since then, however, similar mechanisms, limited in application, have been adopted in two other EU tax laws: that covering e-commerce (in the case of B2C sales); and the withholding taxes to be introduced by Austria, Belgium and Luxembourg under the pending Directive on the taxation of savings interest. This might also become the case with travel agents.

The question then arises: failing the adoption of the definitive VAT system for all intra-EU transactions, could a limited origin system with clearing be introduced for the supply of services alone?

**Redefinition of the default**

The change proposed by the Commission in its consultation paper, however, goes in the opposite direction: a greater use of the "customer's place of establishment" principle, together with greater use of the reverse charge procedure.

Several aspects of this proposal deserve attention.

1. **Elimination of exceptions**

   There would be no decrease in exceptions to the default principle, as compared to the current situation. Though Article 9(2)e of the 6th Directive would no longer be needed, 9(2)a and 9(2)c would have to remain. Article 9(2)b on passenger transport would also remain an exception, though the Commission proposes to examine the issue in the future, taking account of both B2B and B2C transactions. In addition, services physically carried out on moveable property (e.g. repairs) would be taxed on the "supplier's place of establishment" basis (see earlier). Finally, this principle would also have to apply to services like restaurants (also see earlier).

2. **Scope of the change**

   In consequence, the change would in practice affect only a limited number of existing services. Indeed, the first advantage of the change cited by the Commission paper is that it would prepare for the future:

   ...there would be no need to amend the Sixth Directive with respect to taxable persons every time a new service or delivery mode appears.

3. **Requirements to register**

   One effect of the change noted by the Commission paper is that it would, as a result of a greater use of reverse charge,

   *limit the instances whereby a supplier would be required to register for VAT purposes when performing services in a Member State other than where they are established.*

4. **"Bundled" transactions**

   Taxing the cross-frontier supply of services on the same basis as the supply of goods (i.e. invoicing at zero) might simplify procedures in cases of certain "bundled" transactions, as observed by the Commission paper. However, in such cases the customer's place of establishment rule already applies in principle as a result of the 6th Directive's seventh recital.
5. Administrative costs: the role of VIES

The Commission also observes, however, that the switch could lead to "increased administrative demands". In practice, this would mean extension of the VIES system to supplies of services as well as of goods, introducing new reporting obligations but allowing suppliers of services to check the VAT status of their customers (and vice versa).

6. Susceptibility to fraud

In this context, the Commission paper points out that "the reverse charge mechanism is more prone to fraud". This is because it greatly weakens one of the key features of the "classical" VAT system: that it is largely self-policing. The system of charging by sellers, and deduction as input tax by VAT-registered purchasers, creates incentives on both sides to account properly for VAT. Where the seller no longer has any responsibility the incentive is reduced.

7. The 8th VAT Directive procedure

When a customer registered for VAT in one country purchases a service in another country, and pays VAT in that country of supply, the VAT is not, at present, automatically deductible as input taxation. Instead, the customer has to recover the VAT via the procedures provided by the 8th VAT Directive, which can prove both lengthy and costly. A switch to the customer's place of establishment principle, coupled with reverse charge, could make this unnecessary. This improvement, the Commission paper argues, might constitute a quid pro quo for added reporting requirements. On the other hand, it could not apply in cases of restaurants and other services "that are tangible in nature", where the suppliers' place of establishment rule would continue.

However, the Commission has already proposed an alternative solution to the 8th Directive problem: i.e. enabling the customer to deduct the VAT in the normal way. This has been supported by the European Parliament and is currently before Council.

11 COM/98/377
## Table 3: Options for place of supply

<table>
<thead>
<tr>
<th>Place of supply</th>
<th>Invoices</th>
<th>Accounting for tax</th>
<th>Examples of current application</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;Transitional&quot; VAT system: where supplier established</td>
<td>Rate of tax in country where supplier established</td>
<td>• B2B: Frequent need for supplier to establish in country of consumption. Possibility of direct payment from 2002.</td>
<td>• &quot;Default&quot; principle in Article 9 of 6th Directive.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• B2C: Supplier</td>
<td>• Hotels, restaurants, hairdressers, etc.</td>
</tr>
<tr>
<td>&quot;Transitional&quot; VAT system: where customer established</td>
<td>• B2B: 0%</td>
<td>• B2B: Reverse charge (i.e. customer responsible).</td>
<td>• Advertising, legal and accountancy services, consultants, etc.</td>
</tr>
<tr>
<td></td>
<td>• B2C: rate of tax where supplier established.</td>
<td>• B2C: Supplier.</td>
<td>• Financial services (&quot;with the exception of the hire of safes&quot;)</td>
</tr>
<tr>
<td>&quot;Transitional&quot; VAT system: where the service is actually carried out or the benefit enjoyed.</td>
<td>Rate of tax in country of event.</td>
<td>• B2B: Frequent need for supplier to establish in country of event. Possibility of direct payment from 2002.</td>
<td>• Staff agencies and the services of agents.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• B2C: Supplier</td>
<td></td>
</tr>
<tr>
<td>&quot;Definitive&quot; system: origin with clearing</td>
<td>Rate of tax in country where supplier established</td>
<td>By supplier in all cases. Revenue from B2B transactions cleared to country of consumption.</td>
<td>• On buildings and building sites. (&quot;immovable property&quot;).</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• B2C: Supplier. Revenue cleared to country of consumption.</td>
<td>• Cultural, artistic and sporting events, entertainment, etc.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Services carried out on &quot;movable tangible property&quot;: e.g. repairs to cars, shoes, etc.</td>
</tr>
<tr>
<td>e-commerce</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Some special problems

The coming of the "transitional" VAT system in 1993 made only limited changes to the arrangements for the taxation of services. When taxation was levied at the frontier, services ancillary to the delivery of goods – e.g. transport costs – were normally added to the taxable amount of the goods themselves. This has continued to be the case for imports from third countries, irrespective of the Member State into which the goods are imported and of the Member State of final destination. In the case of internal movements of goods, however, any VAT-registered customer is now liable for the tax, unless the supplier of the service is registered in the same Member State.

Unfortunately, there is a snag: these simple rules only apply when the service is ancillary to an intra-Community supply of goods. Those providing services such as loading and unloading are often unable to discover whether this is the case, or to prove it.

Other complications exist in such fields as the carrying out of repairs, when the work can either be carried out on the spot, or the product moved to another Member State for specialist attention. Such services are normally taxable in the place where they are physically carried out (though the Commission now suggests that this should be changed to the supplier's place of establishment – see earlier).

Passenger Transport

One of the most intractable problems, however, is how VAT should be levied on passenger transport.

Article 9.2(b) of the Sixth VAT Directive states that

*the place where transport services are supplied shall be the place where transport takes place, having regard to the distances covered.*

As a statement of principle, this seems logical. As a basis for levying VAT it is virtually unworkable. The situation is – again in the words of the Commission – "fairly chaotic".

Applied à la lettre, the text of the Directive means that any journey across two or more Member States is taxed in "slices", corresponding to the distances covered on each territory. Each slice may be taxed at a different rate; and the revenue from each slice must be paid to a different Treasury. Transport operators must therefore register separately for VAT in all the Member States covered by journeys. Since 1992, moreover, the abolition of checks at internal frontiers has made it extremely difficult to monitor the distances covered in each territory.

Since attempts to tax "slices" of air or sea transport would obviously be futile, these are generally exempt throughout the Community. A majority of Member States have also given up attempts to tax "slices" of international rail, road or inland waterway journeys as well.

In other Member States, however, VAT is levied, generally at the reduced VAT rate. Operators are therefore theoretically obliged to divide up each fare charged according to the distances covered in each Member State, and pay VAT on the appropriate portions, at the appropriate rates, to the appropriate Treasuries. It is "a moot point", says the Commission, "whether these rules..are effectively applied.."

12 See Directive (COM(94)58) and OJ L102 of 5.5.1995
13 COM(94)474.
A general exemption for all such journeys would appear one obvious solution. However, since most Member States levy a positive rate of VAT on internal passenger transport – again generally at the reduced rate – there would be the obvious danger that competition would be distorted: for example, a coach journey taking place within a Member State would be taxed, one travelling the same route, but either starting or ending in another Member State, would not.

Article 28.5 of the Sixth Directive lays down that this situation shall end once the "definitive" VAT system is in place, when

passenger transport shall be taxed in the country of departure for that part of the journey taking place within the Community...

The Commission, however, came to the conclusion that the situation demanded earlier action, and proposed in 1992 a move to the "country-of-departure" principle\textsuperscript{14}. However, as the Report of the European Parliament's Economic and Monetary Affairs and Industrial Policy Committee\textsuperscript{15} observed, there would be problems for

Member States which do apply standard rates and have as neighbour those States which apply zero- or reduced rates. This may incite carriers to fix the point of departure just at the other side of the internal frontier...

The solution advocated by the rapporteur was "a common, uniform reduced or even zero-rate on passenger transport."

A further objection to the country-of-departure, outlined by a working party appointed by the German Ministry of Finance in 1994, is that it would

cause considerable additional burdens for the entrepreneurs concerned since they would have to register for turnover tax in every Member State in which they start a transport operation\textsuperscript{16}.

Instead, the report advocated a return to the principle of taxation at the supplier's place of establishment, irrespective of where the service was carried out.

The draft Directive, in any case, was not adopted.

The Commission's consultation paper postpones any further proposal, beyond excluding passenger transport from any default system for B2B commerce based on the customer's place of establishment.

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.

**Defining "establishment"**

Whether the default principle for the levying of VAT on B2B services is the supplier's or the customer's place of establishment, much can turn on what exactly this means. Article 9.1 currently defines the place, in the case of a supplier, as where the trader


\textsuperscript{15} A3-0427/92, rapporteur Mr. Lyndon HARRISON (OJ C42 of 15.2.1993).

\textsuperscript{16} "Formulation of the definitive system for imposing turnover tax on the intra-Community trade in goods and services and for a functional clearing procedure" (Bundesministerium der Finanzen, April 1994).
VAT ON SERVICES

has established his business or has a fixed establishment from which the service is supplied or, in the absence of such a place of business or fixed establishment, the place where he has his permanent address or usually resides.

How "fixed", however, does an establishment have to be to qualify? What, for example, is the status of the barrow-boy's barrow?

The Commission paper observes that the Court has made a number of rulings on this issue, and has effectively established the principle 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.

Problems can also arise when a taxable person has establishments in more than one Member State, and it is not certain which one actually makes (in the case of "place of supply") or receives (in the case of "place of customer") the service.

Both these issue, the Commission observes, are essentially questions of fact or judgement. One option, therefore, is to leave matters to the courts to be determined on a case-by-case basis.

Alternatively, in order to improve legal certainty, a number of criteria could be introduced by legislation: for example, the establishment making or receiving a supply, in the case of doubt, could be deemed that with the largest number of employees.
Conclusions

The suggestion in the Commission's consultation paper – that the "default" place of supply for services should be switched from where the supplier is established to where the customer is established – would, in practice, have only a marginal impact. The existing place-of-supply rule would continue to apply in a large number of cases, as would that of place-of-consumption; and the existence of such varying rules is the chief cause of complexity and uncertainty in the system.

The change would, nevertheless, bring the system for taxing some services more into line with that currently prevailing in the case of goods. This might improve the situation where goods and services form part of the same transaction (though in such cases the customer's place of establishment rule already applies in principle as a result of the 6th Directive's seventh recital). The reverse charge system also ensures that the destination principle is simply applied, both as regards the rate of tax and the benefit from the revenue.

Other advantages claimed for the change might, however, be better obtained in other ways. For example, the costs of operating the 8th VAT Directive would be best ended by adoption of the 1998 proposal to allow normal deduction in the supplier's country of establishment.

It also needs to be remembered that any change in VAT legislation can give rise new uncertainties. The case law of the ECJ is steadily resolving many of the problems arising from the present rules, and some of this guidance might no longer apply. There would then be fresh litigation and fresh costs.

A further powerful, though theoretical, objection to the change is that it goes in a direction opposite to that of the promised "definitive" VAT system based on the origin principle. Article 9 of the Sixth Directive, despite the many exceptions, already applies this principle as the default. The change would therefore need to be reversed at some future date.

One can only conclude, therefore, that the suggestion made in Commission paper is very much the treatment of a symptom rather than of the disease. A bolder approach might have been to re-affirm the current supplier's place of establishment principle for all services (i.e. the origin principle), and then devise procedures for eliminating the exceptions. This might be achieved, for example, by creating a limited version of the 1987 proposals for origin with clearing, but applying only to services. The coverage could be B2B transactions only; or could even include certain B2C transactions, as in the case of e-commerce.

Finally, notice should be taken of the Commission's warning that extending application of the reverse charge procedure enlarges the scope for fraud. Indeed, the whole "transitional" system based on the destination principle is more vulnerable to fraud than one based on origin, since it impairs the self-policing nature of the VAT system. The suggested change would therefore imply re-inforced control mechanisms, and almost certainly extension of the VIES system to the services affected.

As to the separate question of whether Article 9 might be amended to clarify certain matters in connection with "establishments", it seems unnecessary to define the term itself in the light of ECJ case law. Where there are establishments in different Member States, and it is uncertain which is the place of supply, there might be an argument for introducing a "rule of thumb" such as the number of employees or annual turnover.
Annex 1: Article 9 of the Sixth VAT Directive

Supply of services

1. The place where a service is supplied shall be deemed to be the place 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 of business or fixed establishment, the place where he has his permanent address or usually resides.

2. However:

(a) the place of the supply of services connected with immovable property, including the services of estate agents and experts, and of services for preparing and co-ordinating construction works, such as the services of architects and of firms providing on-site supervision, shall be the place where the property is situated;

(b) the place where transport services are supplied shall be the place where transport takes place, having regard to the distances covered;

(c) the place of the supply of services relating to:
   — cultural, artistic, sporting, scientific, educational, entertainment or similar activities, including the activities of the organisers of such activities, and where appropriate, the supply of ancillary services,
   — ancillary transport activities such as loading, unloading, handling and similar activities,
   — valuations of movable tangible property,
   — work on movable tangible property,

shall be the place where those services are physically carried out;

(e) the place where the following services are supplied, when performed for customers established outside the Community or for taxable persons established in the Community but not in the same country as the supplier, shall be the place where the customer has established his business or has a fixed establishment to which the service is supplied or, in the absence of such a place, the place where he has his permanent address or usually resides:
   — transfers and assignments of copyrights, patents, licences, trade marks and similar rights,
   — advertising services,
   — services of consultants, engineers, consultancy bureaux, lawyers, accountants and other similar services, as well as data processing and the supplying of information,
   — obligations to refrain from pursuing or exercising, in whole or in part, a business activity or a right referred to in this point (e),
   — banking, financial and insurance transactions including reinsurance, with the exception of the hire of safes,
   — the supply of staff,
   — the services of agents who act in the name and for the account of another, when they procure for their principal the services referred to in this point (e).
   — the hiring out of movable tangible property, with the exception of all forms of transport.
   — Telecommunications. Telecommunications services shall be deemed to be services relating to the transmission, emission or reception of signals, writing, 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.

Telecommunications services within the meaning of this provision shall also include provision of access to global information networks.

3. In order to avoid double taxation, non-taxation or the distortion of competition the Member States may, with regard to the supply of services referred to in 2(e) and the hiring out of forms of transport consider:

(a) the place of supply of services, which under this Article would be situated within the territory of the country, as being situated outside the Community where the effective use and enjoyment of the services take place outside the Community;

(b) the place of supply of services, which under this Article would be situated outside the Community, as being within the territory of the country where the effective use and enjoyment of the services take place within the territory of the country.

4. In the case of telecommunications services referred to in paragraph 2(e) supplied by a taxable person established outside the Community to non-taxable persons established inside the Community, Member States shall make use of paragraph 3(b).
Annex 2: Judgement of the Court in Case C-438/01, 5 June 2003

JUDGMENT OF THE COURT (Fifth Chamber)
5 June 2003

(Sixth VAT Directive - Article 9(2)(e) - Place of taxable transactions - Fiscal connection - Advertising services)

REFERENCE to the Court under Article 234 EC by the Cour de cassation (Luxembourg) for a preliminary ruling in the proceedings pending before that court between

Design Concept SA

and

Flanders Expo SA,


THE COURT (Fifth Chamber),
composed of: M. Wathelet, President of the Chamber, C.W.A. Timmermans, D.A.O. Edward, A. La Pergola and S. von Bahr (Rapporteur), Judges,
Advocate General: F.G. Jacobs,
Registrar: M.-F. Contet, Principal Administrator,
after considering the written observations submitted on behalf of:
- Design Concept SA, by M. Di Stefano, avocat,
- the French Government, by G. de Bergues and P. Boussaroque, acting as Agents,
- the Commission of the European Communities, by E. Traversa and C. Giolito, acting as Agents,
having regard to the Report for the Hearing,
after hearing the oral observations of Design Concept SA, represented by M. Di Stefano, of the Greek Government, represented by V. Kyriazopoulos and S. Chala, acting as Agents, and of the Commission, represented by C. Giolito, at the hearing on 14 November 2002,
after hearing the Opinion of the Advocate General at the sitting on 12 December 2002,
gives the following

Judgment


2. That question was raised in the course of proceedings between Flanders Expo SA ('Flanders Expo'), a company incorporated under Belgian law, established in Ghent (Belgium), and Design Concept SA ('Design Concept'), a company incorporated under Luxembourg law, established in Hesperange (Luxembourg), concerning the refusal of the latter to pay value added tax ('VAT') on services which had been supplied to it.

Community legislation

3. The seventh recital in the preamble to the Sixth Directive states:

'Whereas the determination of the place where taxable transactions are effected has been the subject of conflicts concerning jurisdiction as between Member States, in particular as regards supplies of goods for assembly and the supply of services; whereas although the place where a supply of services is effected should in principle be defined as the place where the person supplying the services has his principal place of business, that place should be defined as being in the country of the person to whom the services are supplied, in particular in the case of certain services supplied between taxable persons where the cost of the services is included in the price of the goods'.

17 Language of the case: French
4. Article 9(1) of the Sixth Directive states:

'The place where a service is supplied shall be deemed to be the place 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 of business or fixed establishment, the place where he has his permanent address or usually resides.'

5. Article 9(2)(e) of the Sixth Directive provides:

'[T]he place where the following services are supplied when performed for customers established outside the Community or for taxable persons established in the Community but not in the same country as the supplier, shall be the place where the customer has established his business or has a fixed establishment to which the service is supplied or, in the absence of such a place, the place where he has his permanent address or usually resides:

- advertising services,

...'

The main proceedings and the question referred for a preliminary ruling

6. In connection with a trade fair known as 'Horeca', organised in Ghent for professionals in the hotel and catering business, Design Concept, acting for the Luxembourg Ministry of Economic Affairs, commissioned from Flanders Expo various services including the construction of two stands, the cleaning of those stands during the exhibition and the provision of staff to transport equipment.

7. Flanders Expo submitted an invoice to Design Concept for the price of its services, including in it the amount of VAT. However, Design Concept excluded the amount of VAT from its payment on the ground that since the services supplied were advertising services and the recipient of those services, Design Concept, was not situated in the same Member State as the supplier, Flanders Expo, the place where the services were supplied was where the customer was established, that is to say Luxembourg, in accordance with the rule laid down in Article 9(2)(e) of the Sixth Directive. Design Concept therefore took the view that it was not obliged to pay the VAT claimed from it by Flanders Expo in Belgium.

8. Flanders Expo brought an action before the Tribunal de paix (Magistrates' Court) (Luxembourg) which upheld its claim for payment of VAT. On appeal the Tribunal d'arrondissement (District Court) (Luxembourg) confirmed the decision at first instance, holding, contrary to the interpretation put forward by Design Concept, that the services supplied by Flanders Expo are not advertising services and that the general rule on the place of taxation laid down in Article 9(1) of the Sixth Directive is applicable. According to that rule the place where a service is supplied is the place from which the service is performed, in this case Belgium.

9. The Cour de cassation, to which Design Concept appealed, takes the view that the lower courts were probably wrong to refuse to treat the services supplied by Flanders Expo as advertising services. However, it is uncertain whether their decision is justified on another ground based on the interpretation of Article 9(2)(e) of the Sixth Directive, read in the light of the seventh recital in the preamble thereto.

10. After having recalled the terms of the seventh recital, the Cour de cassation states that if incorporation in the price of the goods of the cost of advertising services were an essential condition for the transfer of taxation to the customer's country, the decision of the lower courts would then be justified, given that in the present case the cost of those services is borne ultimately not by a trader, but by the Luxembourg State which, as the advertiser, commissioned those services from the intermediate customer.

11. Since it was uncertain of the answer to the question of Community law raised by the appeal before it, the Cour de cassation decided to stay proceedings and to refer the following question to the Court for a preliminary ruling:

'Is Article 9(2)(e) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment concerning advertising services applicable to services supplied indirectly to the advertiser and invoiced to a third party who in turn invoices them to the advertiser, if the advertiser does not produce goods in the price of which the cost of the services is going to be included?'

Preliminary observations

12. In its order for reference, the Cour de cassation states that, 'prima facie', the lower courts did not correctly interpret the concept of 'advertising services' referred to in the second indent of Article 9(2)(e) of the Sixth Directive. The question raised by the Cour de cassation is thus founded on the premiss that the services supplied by Flanders Expo are 'advertising services' within the meaning of that provision.
13. However, although it does not form the subject-matter of a question referred for a preliminary ruling, the nature of the services supplied by Flanders Expo has given rise to a considerable number of observations from Design Concept, the French Government and the Commission.

14. In that regard, it should be remembered that it is settled-case law that, in the context of the cooperation between the Court of Justice and the national courts provided for by Article 234 EC, it is solely for the national court before which the dispute has been brought, and which must assume responsibility for the subsequent judicial decision, to determine in the light of the particular circumstances of the case both the need for a preliminary ruling in order to enable it to deliver judgment and the relevance of the questions which it submits to the Court (see, *inter alia*, Case C-379/98 *PreussenElektra* [2001] ECR I-2099, paragraph 38).

15. Thus, in the present case the answer to the sole question referred must proceed from the premiss taken as a basis by the national court, namely that the services in question in the main proceedings are advertising services. Nevertheless, in so far as that premiss is based on a finding that the Cour de cassation itself describes as 'prima facie', it is necessary to point out that the notion of 'advertising services' referred to in the second indent of Article 9(2)(e) of the Sixth Directive is a Community law concept which must be interpreted uniformly (see, *inter alia*, Case C-69/92 *Commission v Luxembourg* [1993] ECR I-5907, paragraph 15) and that it will be for the national court, where necessary, to determine the classification of the services concerned in the light of the case-law of the Court.

**The question referred for a preliminary ruling**

16. By its question the national court seeks essentially to ascertain, first, whether Article 9(2)(e) of the Sixth Directive must be interpreted as applying to advertising services supplied indirectly to the advertiser and invoiced to a third party who in turn invoices them to the advertiser and, second, whether that provision is applicable where the advertiser does not produce goods or services in the price of which the cost of the advertising services may be included.

*The first part of the question*

17. In accordance with the case-law of the Court, the second indent of Article 9(2)(e) of the Sixth Directive must be interpreted as applying not only to advertising services supplied directly and invoiced by the supplier to a taxable advertiser, but also to services supplied indirectly to the advertiser and invoiced to a third party who in turn invoices them to the advertiser (Case C-108/00 *SPI* [2001] ECR I-2361, paragraph 22).

18. It follows that the indirect nature of the services, resulting from the fact that they were supplied and invoiced by a first supplier to an undertaking, which was itself commissioned to perform advertising services, before being invoiced by that undertaking to the advertiser, does not constitute an obstacle to the application of Article 9(2)(e) of the Sixth Directive.

*The second part of the question*

19. Design Concept and the Commission argue that the fact that the advertiser, that is the Luxembourg Ministry of Economic Affairs in the main proceedings, does not produce goods or supply services in the price of which the cost of the services may be included is not relevant to the resolution of this dispute.

20. They take the view that the relationship between the first supplier and the intermediate recipient of the services must be considered independently of the relationship between that intermediate customer and the advertiser. It is, therefore, not necessary to examine the status of the final customer, in this case the advertiser, or, in particular, to ascertain whether it is itself a taxable person and therefore capable of passing on the cost of the services received in the price of the goods or services which it supplies.

21. The French Government takes the contrary view that, if the final recipient of the services does not include the sum paid in consideration for those services in the price of any goods or service which it sells, the rule provided in Article 9(2)(e) of the Sixth Directive is not applicable.

22. In that regard, as is apparent from the seventh recital in the preamble to the Sixth Directive, Article 9 of the directive lays down the rules for determining the place where taxable transactions are effected, for the purpose of avoiding conflicts concerning jurisdiction.

23. Moreover, according to the fundamental principle which underlies the VAT system, VAT applies to each transaction by way of supply of goods or services after deduction has been made of the VAT which has been levied directly on transactions relating to inputs (see, in particular, Case C-62/93 *BP Supergas* [1995] ECR I-1883, paragraph 16).

24. Therefore, the rules for determining the place where a taxable transaction is effected, laid down in Article 9 of the Sixth Directive, must be applied to each transaction by way of supply of services.
25. Thus, in a case such as that in the main proceedings the rule laid down in Article 9(2)(e) of the Sixth Directive must be applied to the services supplied by the first supplier to the intermediate customer.

26. Under Article 9(1) and (2), the determination of the place where a service is supplied depends solely on the place where the supplier and the recipient of the service in question are established. That article in no way requires account to be taken of transactions carried out after that first supply of services.

27. As the Advocate General points out in paragraphs 22 to 33 of his Opinion, the seventh recital in the preamble to the Sixth Directive does not lead to a different interpretation from that which results from paragraphs 24 to 26 of the present judgment.

28. It follows that in a case of an indirect supply of services, such as that at issue in the main proceedings, involving a first supplier of services, an intermediate customer and an advertiser who receives services from the intermediate customer, the transaction by way of supply of services effected by the first supplier to the intermediate customer must be considered separately, for the purpose of determining the place of taxation of that transaction. The rule laid down in the second indent of Article 9(2)(e) of the Sixth Directive applies, as a rule, if the intermediate customer, as recipient of the advertising services, is a taxable person established in a Member State other than that in which the first supplier is based. It is not necessary to determine whether the advertiser, who is the final recipient of the services, is also a taxable person who includes the cost of those services in the price of goods or services supplied by him.

29. The answer to the question referred must therefore be that Article 9(2)(e) of the Sixth Directive must be interpreted as applying to advertising services supplied indirectly to the advertiser and invoiced to an intermediate customer who in turn invoices them to the advertiser. The fact that the advertiser does not produce goods or services in the price of which the cost of the advertising services may be included is not relevant for the purpose of determining the place where the services are supplied to the intermediate customer.

**Costs**

30. The costs incurred by the Greek and French Governments and by the Commission, which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court.

On those grounds,

THE COURT (Fifth Chamber),

in answer to the question referred to it by the Cour de cassation by judgment of 8 November 2001, hereby rules:

**Article 9(2)(e) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes - Common system of value added tax: uniform basis of assessment must be interpreted as applying to advertising services supplied indirectly to the advertiser and invoiced to an intermediate customer who in turn invoices them to the advertiser. The fact that the advertiser does not produce goods or services in the price of which the cost of the advertising services may be included is not relevant for the purpose of determining the place where the services are supplied to the intermediate customer.**

Wathelet
Timmermans
Edward
La Pergola von Bahr

Delivered in open court in Luxembourg on 5 June 2003.

R. Grass
Registrar

M. Wathelet
President of the Fifth Chamber
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