COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 29.01.1997
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Proposal for a

COUNCIL DIRECTIVE

amending Directive 77/388/EEC
as regards the value added tax arrangements
applicable to telecommunications services

(presented by the Commission)

EXPLANATORY MEMORANDUM

I. Introduction

The aim of this proposal is to amend the VAT rules applicable to telecommunications services. The amendments are necessary in order to prevent distortions of competition resulting from the current legislation.

The fiscal rules currently in force do not take account of technological progress in telecommunications, with it now being possible to provide services from anywhere in the European Union or the rest of the world. Community legislation should therefore be adapted to this new situation in order to restore the neutrality of the tax.

Problems to be resolved

Today, telecommunications services are taxed at the place of establishment of the service provider, which is generally the place where the telecommunications company has established its business or has a fixed establishment. This definition of the place of taxation (Article 9(1) of the Sixth Directive) gives rise to two sets of problems:

The first difficulty has to do with the influence of the VAT system on the competitiveness of Community operators. If establishment in the Community is the only condition making an operator liable for Community VAT on any telecommunications service he provides, irrespective of whether the service is provided inside or outside the Community and irrespective of the status of his customer, then that operator will clearly always be subject to Community VAT, whereas competitors established in third countries will not.

The other problem is that it is impossible at present effectively to tax all telecommunications services consumed within the Community. All a customer in the Community has to do in order to escape payment of VAT is to use the services of a telecommunications company established in a third country. The liberalisation of the telecommunications sector together with technical facilities make this even easier for him. These practices are causing major revenue losses to Member States' budgets.

The situation can therefore be summed up as follows: the current VAT system disadvantages Community operators who are handicapped by not being able to compete with third-country operators on markets outside the Union, whereas technical arrangements are enabling third-country operators to take advantage of the fact that they are not subject to Community VAT, and this is reducing the tax collected. Moreover, Community firms which do not have the right to deduct in full the VAT they pay on their purchases (such as banks and insurance companies) can reduce their costs in this way, at the expense of competitors who purchase the same services from a Community operator.

What approach should be taken?

Since VAT is a general tax on consumption, any amendment of existing legislation must more effectively capture consumption in the Community, while preventing the distortions of competition that currently take place.

The mobile nature of telecommunications services combined with the technical potential for physically locating or relocating the service anywhere in the world rule out an approach based on the place where the service is physically performed. Since the current arrangements focusing on the place of establishment of the service provider have proved inadequate in the cases of telecommunications services "imported" from or "exported" to third countries, there is no alternative but to look to the customer with a view to defining more precisely the consumption of a service within or outside the Community. Consumption can thus be deemed to take place from the moment when the customer receives the routed signal or when the emitted signal is routed on his behalf.

Conclusion: To determine whether a telecommunication service falls within the scope of Community VAT and in order to avoid distortions of competition between Community and non-Community suppliers of telecommunication services one has to consider the place of establishment of the recipient..

Analysis of technical options

Shifting the place of taxation from the place of establishment of the service provider to that of the customer has implications which need to be looked into in greater detail:

(a) Providers established within the Community

Once the place of taxation is determined by the place of establishment of the customer, the general rules governing VAT would require the service provider to be identified for VAT purposes in all Member States where he has customers. Compared with the present situation, in which the service provider fulfils all his VAT obligations in the Member State where he is established, this would be a retrograde step and would add to the difficulties which prompted the Commission to draw up a programme for introducing the definitive VAT system (doc COM(96 328 final).

Conclusion: The solution sketched out for the future VAT system should be applied at this stage: telecommunications service providers should be identified for VAT purposes in a single Member State for all the services they provide in the European Union.

(b) Providers established outside the Community

Service providers who do not have a fixed establishment within the Community should normally be subject to the same constraints as Community operators. If a solution is sought to avoid Community operators having to be identified for VAT purposes in each Member State in which they have customers, then the same reasoning should apply to non-Community operators.

Conclusion: The principle of a single VAT identification within the European Union should also apply to operators who are not established within the Union.

(c) "Reverse charge" and procedure for refunding tax

The advantage to a service provider of having to be identified for VAT purposes in only one Member State would be counterbalanced by the difficulties faced by the customer in recovering the VAT he has paid on telecommunications services. If the customer is not established in the same Member State as the service provider, he will have to apply for the VAT to be refunded in accordance with the procedure established by the Eighth VAT Directive. The desire to avoid the need for such formalities is one of the reasons why the "reverse charge" mechanism (whereby the taxable person acquiring the services becomes liable for the tax and has to fulfil all the tax obligations instead of the service provider) is applied to the intangible services listed in Article 9(2)(e). There are, however, fundamental reasons for not applying such a mechanism to telecommunications services.

The main argument is based on the principle of equity in taxation. While the "reverse charge" mechanism can offer advantages in eliminating procedures for the refund of VAT on purchases, it also has drawbacks in terms of the scope for monitoring non-Community operators and the incentive for them to declare all the services they provide to customers in the Community. The "reverse charge" mechanism would release non-Community service providers from all tax obligations in so far as their customers were taxable persons; they would, on the other hand, still be subject to the full extent of these obligations when providing services to non-taxable persons. Since the tax administration has little scope for monitoring non-taxable persons, it must have greater means of supervising service providers; hence the need for non-Community operators to declare all their taxable transactions in the Community. Without such a requirement, amending the VAT rules for telecommunications services would have an impact only on taxable persons who are not entitled to deduct input tax in full, namely banks and insurance companies, and would achieve only incomplete taxation of consumption in the Community, with the taxation of consumption by private individuals remaining a dead letter.

A practical consideration is also worth mentioning: it is virtually impossible for an operator in a third country to ascertain and check whether or not his customer ranks as a taxable person. This is because the system put in place in the Community under the transitional VAT arrangements for identifying taxable persons is not available outside the Union. But the distinction between taxable and non-taxable persons would determine the tax rules applicable and the tax obligations incumbent on non-Community operators. Moreover, the current application of Article 9(2)(e) to intangible services takes account of this difficulty by ruling out taxation of non-taxable persons and thereby avoiding the imposition of any tax obligation on non-Community operators.

Lastly, non-application of the "reverse charge" mechanism would not result in a particularly heavy burden on customers who are taxable persons, since the situation would not differ from that currently prevailing within the Community. The way in which Article 9(1) is currently applied has the same consequences.

Conclusion: A "reverse charge" mechanism should not be applied.

(d) Transmission and Terminal charges

The only area where application of the procedures for refunding VAT can create major problems is the invoicing of routing and terminal charges between operators of different telecommunications networks. What is involved here is the settlement of accounts between different telecommunications companies in respect of their involvement in a service provided to a customer. A telephone call from Luxembourg to the United States can thus involve several telecommunications operators in addition to the Luxembourg postal and telecommunications administration, e.g. the Belgian, UK and American telecommunications companies, or the French and American telecommunications companies, or others still, according to how the signal is actually routed. With each company billing for its involvement in the service, the consequence of applying VAT would be that large amounts of tax would have to be paid before they could be recovered, some time later, via the refund procedures. To avoid difficulties of this kind, the Melbourne Convention suggests exemption from the tax. Although exemption would depart from usual practice and would be difficult to integrate into the Community's existing VAT arrangements, it appears to offer an appropriate solution to the problem, except that the "reverse charge" mechanism should not be applied, for the other reasons set out earlier.

Conclusion: Routing and termination services provided between different telecommunications companies should be exempted from the tax.

(e) Definition of telecommunications services

In applying the proposed rules it is necessary to have a definition of telecommunication services. It is important that this definition covers only the telecommunication "transmission" service itself and not the content which is transmitted because, otherwise, this could lead to different treatment of the "content" according to the mode of transmission (telecommunication or other).

In principle it would be preferable to use an existing definition of telecommunication services such as that relevant to legislation in the telecommunications sector itself based on Article 90 and 100-A of the Treaty. However it is apparent that this definition was not established for fiscal purposes and gives rise to certain problems. Alternatively there is the definition used in the Melbourne Convention which has the advantage of being accepted at international level, a point which is important for a system which is to be applied equally to telecommunications providers not established in the Community.

Conclusion: For the purposes of this proposal, the definition of telecommunication services contained in the Melbourne Convention is the most appropriate.

General Conclusions

The new regime for the taxation of telecommunication services provides the same conditions and fiscal framework for all telecommunication providers having activities within the Community independent of the place of establishment of those operators (within or outside the Community).

This Directive deals only with telecommunication in the strict sense and not with the so-called "value added" services.

II. Comments on individual articles

Article 1

Point 1

Place of taxation and definition of telecommunications services

Specific rules for determining the place of taxation for the supply of telecommunications services are laid down in point 1. They are designed to adjust the territorial scope of VAT by replacing the criterion of the place of establishment of the service provider with that of the acquirer of the service for telecommunication services other than those supplied by Community operators to their Community customers.

Consequently, services supplied by Community service providers to customers established outside the Community are no longer subject to the tax (first subparagraph). On the other hand, since the second paragraph provides that the place of taxation for telecommunications services supplied by a service provider established outside the Community to customers established within the Community (whether taxable persons or private individuals) is the place of establishment of the customer, all consumption within the Community is brought within the scope of the tax. The rules on the place of taxation for telecommunications services supplied by Community operators to Community customers remain unchanged (Article 9(1)).

The new approach would normally require a third-country operator to be identified for VAT purposes in the Member State of his customer. To avoid the need for multiple VAT identifications in the Community, a non-Community operator is deemed to be established within the Community once he is identified for VAT purposes in one Member State (last sentence of the second indent).

The definition of telecommunications services reproduces the definition used in the Melbourne Convention with an additional clarification. That definition includes the provision of networks and infrastructures such as cables or satellites used for the purposes of telecommunication, of access to Internet and of electronic courier networks.

Point 2&3

Full exemption for terminal charges

As envisaged in the Melbourne Convention, charges for supply of services related to routing and terminating telephone calls are exempted from VAT, although the right to deduct input tax is maintained.

Point 4

Deletion of point 5 in Annex F

Point 5 of Annex F has become obsolete since all Member States now tax supplies of telecommunications services. It is therefore repealed.

Articles 2 to 4

These are standard provisions.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 99 thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament,

Having regard to the opinion of the Economic and Social Committee,

Whereas Article 7a of the Treaty defines the internal market as an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaty;

Whereas the rules currently applicable to VAT on telecommunications services are inadequate for taxing all such services consumed within the Community and for preventing distortions of competition in this area;

Whereas, in the interests of the proper functioning of the internal market, such distortions must be eliminated and new harmonised rules introduced for this type of activity;

Whereas action should be taken to ensure that telecommunications services used by customers established within the European Union are taxed;

Whereas, for the purpose of establishing a special rule for determining the place of supply of telecommunications services, these services need to be defined; whereas such definition should draw on definitions already adopted at international level, which include international telephone call routing and termination services;

Whereas it has been agreed at international level, under the Melbourne Convention, to exempt telecommunications services supplied between telecommunications network operators; whereas this approach should be followed at Community level,

HAS ADOPTED THIS DIRECTIVE:

Article 1

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

1. In Article 9(2) the stop is replaced by a semi-colon and the following section is added:

"(f) the place of supply of telecommunications services is the place where the customer has established his business or has a fixed establishment for 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, if that place is outside the Community;

the place of supply of telecommunication services provided by a supplier established outside the community to a customer who has established his business or has a fixed establishment for 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 within the Community, is the place where the customer is established. If a service provider established outside the Community is identified for VAT purposes in a Member State on account of having supplied a telecommunications service there, he shall be deemed, for the purposes of this Article, to be established in that Member State;

telecommunications services shall be deemed to be services relating to the transmission, emission or reception of signs, signals, writing, images and sounds or information of any nature by wire, radio, optical or other electromagnetic systems, including the transfer or assignment of the right to use capacity for such transmission, emission or reception."

2. In Article 13(B), the stop is replaced by a semi-colon and the following point is added:

"(i) the supply, between telecommunications network operators, of telecommunications services relating to the routing and termination of telephone calls."

3. In Article 28f(1), "13(B)(i)," is inserted in Article 17(3)(b) after the words "...pursuant to Article".

4. In Annex F, point 5 is deleted.

Article 2

1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by 1 January 1999 at the latest. They shall inform the Commission thereof.

   When Member States adopt these measures, they shall contain a reference to this Directive or shall be accompanied by such reference at the time of their official publication. The procedure for such reference shall be adopted by Member States.

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

Article 3

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

Article 4

This Directive is addressed to the Member States.

Done at Brussels,

For the Council
The President

FINANCIAL STATEMENT

The proposal for a Directive will, once adopted, have the effect of increasing the Community's VAT own resources base.

Changing the place of taxation for telecommunications should make it possible to bring the consumption of this type of services in the European Union more effectively within the scope of the tax, since the transactions that will become taxable will be more numerous than those that will cease to be taxable because they are deemed to be supplied outside Community territory.

However, the increase in own resources cannot be estimated precisely in view of the huge difficulty of quantifying all the variables that will influence the net result: turnover in the transactions concerned, input VAT, services supplied by service providers established in third countries, breakdown between customers who are taxable persons with or without the right to deduct and customers who are not taxable persons.

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