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Chris Alexiou

David Morrison

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The Cross-Border Electronic Supply EU-VAT Rules : Lessons for Australian GST

Abstract

Consumption tax on electronic commerce ('e-commerce') is a matter of concern for both the OECD and the Australian taxation authorities.

The OECD established a legal framework for consumption taxation of electronic supplies in a cross-border trade environment. Based on these principles, the EU adopted VAT rules on electronic supplies. Australia has been reluctant thus far. This article examines whether the amended EU-VAT Directive might serve as a model for Australia's GST regime. The VAT and GST legislation of both the European Union and Australia is analysed and compared, with particular focus on cross-border e-commerce supplies and enforcement issues. The political and administrative aspects of EU-VAT Directives are also considered. The article concludes that the provisions of the EU-Directive concerning e-commerce are transferable to the Australian GST regime.

Keywords

GST, goods and service tax, Australia, consumption tax, electronic commerce

THE CROSS-BORDER ELECTRONIC SUPPLY EU-VAT RULES: LESSONS FOR AUSTRALIAN GST

*by C Alexiou and D Morrison**

Consumption tax on electronic commerce ('e-commerce') is a matter of concern for both the OECD and the Australian taxation authorities.

The OECD established a legal framework for consumption taxation of electronic supplies in a cross-border trade environment. Based on these principles, the EU adopted VAT rules on electronic supplies. Australia has been reluctant thus far. This article examines whether the amended EU-VAT Directive might serve as a model for Australia's GST regime. The VAT and GST legislation of both the European Union and Australia is analysed and compared, with particular focus on cross-border e-commerce supplies and enforcement issues. The political and administrative aspects of EU-VAT Directives are also considered. The article concludes that the provisions of the EU-Directive concerning e-commerce are transferable to the Australian GST regime.

OECD

The OECD sees its role as a facilitator in encouraging e-commerce:¹

This programme includes work to foster a stable and predictable regulatory environment; to promote the enhancement of the information infrastructure and access to that infrastructure, by support for a competitive marketplace; and to address constructively such issues as consumer protection and privacy.

* Chris Alexiou, Lawyer, Travers Smith Braithwaite, Berlin, Germany; Dr David Morrison, Senior Lecturer, Fellow, Centre for Public, International and Comparative Law, TC Beirne School of Law, The University of Queensland.

1 Advisory Commission on Electronic Commerce, *Report on behalf of the Secretariat of the Organisation for Economic Co-operation and Development (OECD)*, Paper delivered by Andrew Marsland, Chair of the Sub-group on electronic commerce, Consumption Taxes Working Party, Committee on Fiscal Affairs, San Francisco, 14-15 December 1999;
<http://www.ecommercecommission.org/document/183andrewMarsland.pdf>;
downloaded 10 November 2004.

The OECD position has been to assist dialogue between member and non-member economies and the businesses operating within them to better understand and deal with the taxation issues of e-commerce. The OECD believes that the objective is to achieve 'a fiscal climate within which e-commerce can flourish, but which at the same time protects the revenue base and so the revenue yield'.² Whilst the OECD does not make taxation laws per se, it does have an impact upon them through the e-commerce debate and the various norms that are agreed between states, including the OECD Model Tax Convention and bilateral taxation treaties formed between states that flow from that framework.

The underlying philosophy is an appreciation of the impact of e-commerce upon the various states and the implications of its use in an international trading community, where it is assumed that it is in the interests of all for there to be free and open competition.³ Underlying such sentiment are the canons of a desirable taxation system as outlined by Adam Smith⁴ and incorporated by the OECD into its key conclusions as to 'framework conditions':⁵

- That the same principles that governments apply to taxation of conventional commerce should equally apply to e-commerce, namely:
- Neutrality – in that taxation should seek to be neutral and equitable between forms of e-commerce and between conventional and electronic commerce, so avoiding double taxation or unintentional non-taxation;
- Efficiency – in that compliance costs to business and administration costs for governments should be minimised as far as possible;
- Certainty and simplicity – in that tax rules should be clear and simple to understand, so that taxpayers know where they stand;
- Effectiveness and fairness – in that taxation should produce the right amount of tax at the right time, and the potential for evasion and avoidance should be minimized;

2 Ibid 2.

3 Ibid 4-5.

4 Smith A, *An Inquiry into the Nature and Causes of the Wealth of Nations*, Book V, Part II, 'Of the Sources of the General or Public Revenue of the Society' (5th ed, Methuen and Co Ltd, London, 1904).

5 Advisory Commission on Electronic Commerce, *Report on behalf of the Secretariat of the Organisation for Economic Co-operation and Development (OECD)* 5-6.

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- Flexibility – in that taxation systems should be flexible and dynamic to ensure they keep pace with technological and commercial developments;
- That these principles can be applied through existing tax rules, and that any new or revised administrative measures in the framework of those rules should be directed toward the application of existing principles and should not be intended to impose a discriminatory tax treatment on e-commerce;
- That the technologies underlying e-commerce offer significant opportunities for improved taxpayer service, which governments should actively pursue; and
- That the process of putting flesh on these principles should involve an intensified dialogue with business, with non-business taxpayer groups, and with non-OECD member economies.

It is useful to consider the EU-VAT rules to understand the ambit of their operation and their fit with the overall objectives of the OECD.

EU-VAT rules

The establishment of an internal market where goods and services are exchanged without tax and administrative obstacles between the member states is a fundamental objective of the European Community. To ensure the concept of an area without internal frontiers, the European Community Treaty contains harmonization provisions. To this end Article 93 of the European Community Treaty authorises the European Council to adopt VAT Directives. The EU members are required to implement the Directive's requirements into domestic law. Since 1967 several VAT Directives have been released and for the supply of goods and services the Sixth Directive (1977) is of particular importance.

Under Article 2 of the Sixth Directive 'the supply of goods or services effected for consideration within the territory of the country by a taxable person' is subject to value added tax. The VAT is levied on any supplies of goods and services in the production and distribution chain. However, only the final consumer bears the tax, since taxable persons can deduct the amount of VAT paid on the purchase of goods and services used for the purposes of their taxable transactions. 'Taxable person' (Article 4(1)) means any person who independently carries out, in any place, any economic activity.

In general, transactions are subject to VAT within the member country, within the EU (intra-community) and when imported from outside of the EU (cross-border).

In addition, the EU-VAT rules distinguish between goods and services (tangible or intangible goods) and between transactions performed for business customers and private customers (B2B and B2C).

Supply of goods

The supply of goods (Article 5(1)) means the transfer of the right to dispose of tangible property as owner. According to Article 8 the place of supply of goods is 'where the goods are at the time of dispatch or transport to the person to whom they are supplied.' This means that the place of supply is where the shipping begins.

For intra-community transactions between taxable persons (B2B), the supply of goods is VAT exempt in the Member State of the selling enterprise. The recipient pays the VAT of the delivered good at the rate applicable in its member country. Goods purchased within the EU by a private consumer (B2C) outside the Member State where they reside are free of VAT in the state of residence (Article 8 (1)). However, purchases from mail order companies or sales where the goods are shipped by or on behalf of the supplier may be taxed at the place where transport terminates if distance-selling rules apply. If sales to consumers in a specific member state exceed a certain threshold amount, the supply is not taxed where transportation begins but at the place where the customer resides.

In contrast, cross border supplies of goods are taxed according to the destination country principle. Hence, exports are exempt from VAT and imports of goods are subject to VAT at the border of the Member State.

Supply of services

Any transaction that does not constitute a supply of goods within the meaning of Article 5 is deemed to be a supply of a service (Article 6 (1)). Under EU-VAT rules the term 'service' lacks a specific definition.

The general rule for the taxable place of supply is the location where the supplier has established its business (Article 9(1)). The place of supply may, however, be somewhere other than the supplier's business establishment. This depends on the type of service provided, the status of the customer, and upon the supplier's and customer's country of establishment.

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Art. 9(2) provides for a list of different services with their specific place of supply rules as follows:

Article 9

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...
2. However:
 - (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...:
 - transfers and assignments of copyrights, patents, licences, trade marks and similar rights,
 - advertising services,
 - services of consultants, engineers, lawyers, accountants and other similar services,
 - data processing and the supplying of information...

In the case of intra-community supplies of services between taxable persons (B2B), the taxable place of supply can be either at the supplier's establishment or at the customer's business establishment. If one of the services listed in Article 9(2)(e) is provided to a taxable person, the place of supply is the customer's place of business. However, services other than those mentioned in Article 9(2)(e) are taxed in the Member State where the supplier's business is established.

The place of supply for cross-border services depends on the type of service, the status of the customer and the country of establishment. According to Article 9(2)(e) the place of supply of services for business or private customers residing outside the European Community is the customer's place of business. Thus, no EU-VAT is chargeable at that point. However, supplies of services listed under Article 9(2)(e) between non-EU and EU-businesses are subject to VAT of the member country, and, the EU-business is liable to remit the VAT to the domestic tax authority (reverse charge mechanism). Article 9(2)(e) does not apply to private

customers within the EU and where the recipient is a European private customer, the offshore business will not have to charge EU-VAT, since the general rule of Article 9(1) applies.

An example illustrates the different place of supplies for intra-community and cross-border supplies of services. A law firm in Germany, say, provides legal advice to a company based in France. Since the legal advice is a service covered by Article 9(2)(e), the taxable place of supply is France. If however the advice was supplied to a private customer in France (B2C), the general rule of Article 9(1) applies. As a consequence the German law firm has to charge German VAT. Note that no EU-VAT is due if the German law firm had advised a company or a private consumer in Australia. If a French private consumer seeks legal advice from a law firm established in Australia, the supply will not be subject to EU-VAT (Article 9(1)). However, if the French customer is a business customer, than EU-VAT is due under the reverse charge mechanism.

Cross border electronic supplies

We distinguish e-commerce from conventional commerce in that e-commerce conducts business by electronic means and conventional commerce by the physical means. Where there is a combination of conventional and e-commerce then there is no difference in the treatment of the transaction from purely conventional transactions.⁶ For example, where tangible goods are delivered to the customer or services are physically performed, but they are ordered, advertised, invoiced and paid on-line.

Where a supply is made in electronic form (an electronic supply), this refers to the delivery of intangibles through the medium of a digital channel. The delivery is not made by post service or commercial courier, but by the Internet. As electronic transactions are delivered digitally and therefore not in physical form, the categorization of the EU-VAT rules of the sixth Directive into goods or services seems clear. E-commerce supplies are deemed to be services, because they are not considered to be tangible items.

With the classification of digital supplies as services, the provision of Article 9 comes into play. The general rule is that electronic services are taxed at the place of the establishment of the supplier. Some electronic supplies, however, may be covered by Article 9(2)(e) and therefore be taxable at the place of the customer.

6 Luc Hinnekens, 'An updated overview of the European VAT rules concerning electric commerce' 2002 (2) *EC Tax Review* 65, 66.

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Article 9(2)(e) includes, for instance data processing and supply of information. Even if the supply of software, electronic books or newspaper can be classified as a supply of information, the majority of e-commerce services will not be covered by Article 9(2)(e).

Aside from issues of definition and scope with in the meaning of 'supply of information'; the different place of supply rules for electronic services results in unequal treatment of electronic commerce transactions.

Furthermore, this has a distorting effect on competition between intra-community and cross border suppliers. Where an Australian business is not required to charge VAT when supplying to EU customers, the supply of e-commerce services by EU based businesses to a non-EU customer, is subject to EU-VAT. Non-EU online suppliers are also not liable for VAT, when supplying to EU business customers, unless the service falls under Article 9(2)(e). As a result, export of e-commerce services are subject to EU-VAT, imports are not.

EU-VAT and competitive distortion

The EU-VAT rules apply both the origin and destination principles according to the circumstances of the supply. Based on the origin principle set out in Article 8(1) and Article 9(1) most transactions are taxable in the Member State where the supplier has established its business. As a result, if the supplier and customer reside in the same country both principles overlap. However, they do have a different effect in the event of cross-border supplies.

For cross-border supplies of goods the EU-VAT rules favour the destination principle. Goods delivered outside the EU are exempt from VAT. EU-based taxable persons supplying goods to customers outside the EU are not double-taxed given that most consumption tax regimes tax imports. The exemption for exports allows EU-suppliers to compete with, say, Australian suppliers in the Australian market on importation into Australia as consumption tax is only imposed once.

Conversely, goods imported are subject to VAT in the EU member country. The customer purchasing a product either from a resident supplier or imported from an Australian company pays in both cases, the VAT applicable in its country of residences. Under the standard consumption tax regimes EU and non-EU suppliers are uniformly exposed to VAT. Thus, competitive neutrality for a given market is achieved.

For consumption taxation of services, a level playing field for EU and non-EU suppliers was not established.⁷ Article 9 did not reflect a consistent rule of place of supply for cross-border services. The concept of levying VAT on imports and exempting VAT on exports was only partially upheld. Under Article 9(2)(e) the supply of services to business customers or private customers residing outside the EU are exempt from EU-VAT, whereas imports are taxed. Within its scope, Article 9(2)(e) achieves competitive neutrality for EU and non-EU suppliers. Taxation is at the place of consumption. Yet, Article 9(2)(e) applies to limited types of services. All other services are taxable at the place where the supplier has established its business. This could result in VAT on export of these services and further tax on import into another jurisdiction that follows normal consumption tax principles.

For cross-border electronic supplies the EU-VAT rules amounted to distortion of competition because non-EU suppliers were not subject to EU-VAT, whereas EU-suppliers were required to charge VAT.

Amendment of the Directive concerning e-commerce supplies

In response to the competitive distortion, the Council of the European Union adopted an amendment to the sixth Directive (77/388/EEC) on 7 May 2002. This required the member states to bring into force the laws, regulations and administrative provisions necessary to comply with this Directive on 1 July 2003.

In its preamble the Directive states that 'the rules currently applicable to VAT [...] on electronically supplied services under Article 9 [...], are inadequate for taxing such services consumed within the Community and for preventing distortion of competition in this area'.

Electronically supplied services should be taxed for customers established in the Community. As a result, taxable persons based outside the European Union providing e-commerce supplies to business and private customers established in the Community are subject to VAT at the place of the recipient.

Conversely, under the Directive electronically supplied services by taxable persons established in the European Union to consumers outside the European Union should not be taxed.

7 Richard Doernberg, Li Jinyan, Luc Hinnekens, 'Electronic Commerce and Multijurisdictional Taxation' 2001 *Kluwer Law International* 555.

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The Directive adds the following at the end of Article 9 (2)(e); ‘- electronically supplied services, inter alia, those described in Annex L’.

The Annex provides an illustrative list referring to examples of e-commerce services:

- Website supply, web-hosting, distance maintenance of programs and equipment.
- Supply of website and updating thereof.
- Supply of images, text, information, and making databases available.
- Supply of music, films and games, including games of chance and gambling games, and of political, cultural, artistic, sporting, scientific and entertainment broadcasts and events.
- Supply of distance teaching.

Since Article 9(2)(e) does not cover supplies between non-EU business and EU-consumer (B2C), Article 9(2)(f) was enacted as follows:

The place where services referred to in the last indent of subparagraph (e) are supplied when performed for non-taxable persons who are established, have their permanent address or usually reside in a member state by a taxable person who has established his business or has a fixed establishment from which the service is supplied outside the Community or, in the absence of such a place of business or fixed establishment, has his permanent address or usually resides outside the Community shall be the place where the non-taxable person is established, has his permanent address or usually resides.

To sum up, the place of supply is where the customer has its residence. The effects of the amendment result in a VAT taxation of ‘imported’ e-commerce supplies and VAT exemption on exported e-commerce transactions.

On cross-border transactions, the distortions between EU and non-EU suppliers are indeed eliminated. Nevertheless, the level playing field between EU and non-EU businesses supplying to consumers residing in the Community is still not achieved.⁸ The taxable place of supply is different because the origin principle applies to intra-community e-commerce supplies to consumers within the

8 Alan Sinyor, ‘EU VAT on e-commerce: The practical implications’ (2002) *International Tax Review* 35.

European Union, whereas the place where the EU consumer is established determines the VAT rate. For example, a German company providing web-hosting services for a Swedish private consumer is required to charge German VAT (16%). The general rule of Article 9(1) applies since Article 9(2)(e) covers only customers outside the EU and business customers established within the EU. Private customers residing in the EU are not contemplated by Article 9(2)(e). The same service offered by an Australian operator is subject to Swedish VAT (25%) (Article 9(2)(f)). Conversely, there are circumstances where the EU business is placed at a competitive disadvantage.

Compliance and enforcement provisions

In order to facilitate compliance with VAT obligations by businesses providing electronic services, which are neither established nor required to be identified for VAT purposes within the Community, a special scheme is introduced which offers an on-line registration in a single member state. Although the non-EU supplier still needs to charge the VAT rate applicable to the country where it provides the service, the taxable business is not required to register in each member state in which it supplies electronic commerce services. The optional scheme of the single place of registration relieves significantly the administrative burden for the operator without encouraging registration in the Member State with the lowest rate.⁹

In addition, a compliance mechanism is provided that allows non-EU operators to fulfil their fiscal duties without designating a tax representative or even establishing a physical presence.

Any operator opting for the special scheme laid down in Article 26c of the Directive is granted a refund on any input value added tax that it has paid on goods and services used by it for the purpose of its taxed activities falling under the special scheme.

However, non-established taxable suppliers are required to comply with provisions imposed by the directive and 'with any relevant existing provision in the Member State where the services are consumed'.¹⁰

9 Luc Hinnekens, 'An updated overview of the European VAT rules concerning electric commerce' (2002) 2 *EC Tax Review* 70.

10 'The non-EU business has to make a statement (electronically) to the tax authority of the member state, which it has chosen to contact, when its activity commences including identification details such as name, address, website url, and national tax

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This requirement has been called to be ‘a frightening prospect for non-EU sellers’ and as ‘onerous’. It appears that the statements are somewhat exaggerated and do not take into account the difficulties encountered and acknowledged by the EU of verification issues in e-commerce and the related difficulties for online operators in obtaining reliable information about customers.

The EU Council adopted an amending regulation on administrative cooperation and of VAT on electronic commerce in order to assist non-EU operators to complying with the Directive’s obligations.¹¹

To comply with the special scheme in Article 26c of the Directive, the non-EU business must know whether or not it has to charge VAT on the supply. ‘It is thus clear that the non established taxable person needs certain information about his customer.’¹² Article 6 (4) of the Council Regulation, therefore, sets out that each member state is to ensure that persons supplying services referred to in the last indent of Article 9(2)(e) are allowed to obtain confirmation of the validity of the VAT identification number of any specified person. The operator can then the compare the information given by its customer (by pull-down menu or billing address) with the VAT identification register of the country in question.

Nonetheless, non-EU suppliers do face a higher compliance burden than their European counterparts. Unlike EU-based businesses, which charge the VAT of their own country, non-established operators bear the burden of identifying the residence of an EU customer. For private customers the VAT database will not

number; the business then receives an identification number from the responsible member country; the non-established business is required to submit by electronic means to the member state, identification and a value added tax return for each calendar quarter indicating whether or not electronic services have been supplied; finally, the total tax obligation is due to be paid when submitting the return.’ Notwithstanding these facilitation measures the compliance burden imposed on non-established businesses seems to be relatively demanding. In order to submit the VAT return correctly, non-EU operators are required to verify the status of the customer (business or private) and the country where the services have been supplied. Article 26c of the Directive requires that ‘the non-established taxable person shall keep records of the transactions covered by this special scheme in sufficient detail to enable the tax administration of the member state of consumption to determine that the value added tax return [...] is correct’.

11 Council Regulation (EC) No 792/2002 of 7 May 2002 amending temporarily Regulation No 218/92.

12 Council Regulation (EC) No 792/2002, Whereas: (5).

assist, since it will not reveal their country of residence. Non-EU businesses therefore have to rely on self-identification by customers or other indications like the country code of the customer's credit card. In addition, the necessary verification process may slow down the online transaction. This could possibly result in a competitive disadvantage, as EU-business is able to provide the electronic service immediately.

A further difference in treatment is the VAT refund system for non-established businesses. An EU-based supplier recovers its input tax as it accounts for VAT paid on its acquisition with the same tax return.¹³ On the other hand non-EU businesses are required to claim refunds of input tax by separate application to the tax authority of each member country. The procedure of accounting for the VAT paid on the sale of goods and services (output tax) together with the VAT on input tax does not apply. This represents an administrative flaw which results in an unequal compliance burden and may reduce compliance with the provision.

The Commission originally proposed a registration threshold (Euro 100, 000) for non-EU businesses providing electronic commerce services to EU consumers. The Commission intended the threshold as a practical measure to facilitate the functioning of the tax system and aimed to avoid 'placing undue burdens on the development of international e-commerce and in particular on very small businesses or on those only making occasional sales to EU consumers'.

While this facilitation measure would have minimized the compliance burden for small and medium sized non-EU enterprises, it would have also resulted in a discriminatory treatment of EU suppliers, since no threshold applies to them. The member states therefore rejected the initial proposal pointing out that according to the OECD recommendations 'countries should seek to apply registration thresholds in a non-discriminatory manner.'¹⁴ However, equal treatment might have been achieved by applying threshold for both EU and non-EU suppliers.

Place of business and fixed establishment

Since different rules apply to cross-border and intra-community supplies, the determination of the place from where the business is deemed to provide electronic supplies is important. Furthermore, it allocates the consumption tax due

13 Alan Sinyor, 'EU VAT on e-commerce: The practical implications' *International Tax Review* (2002) 13 (6), 37.

14 OECD, *Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions* (2001) OECD 31.

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between the jurisdiction where the supplier has its head office and the country in which the supplier has a business established.

For cross-border electronic commerce, the VAT concept of place of business and fixed establishment is particularly important for transactions to consumers, given that electronic supplies from non-EU businesses to consumers in the EU are taxed at the VAT rate of the consumer's place (Article 9(2)(f)) whereas intra-community supplies to private customers are subject to the VAT rate at the place of the supplying business (Article 9(1)).

As we have shown the same electronically supplied service can result in different applicable VAT rates. For example, if an Australian operator provides electronic commerce services to a private consumer in Sweden, the applicable Swedish VAT rate would be 25%. By contrast, a German internet company supplying the same service as its Australian competitor needs to charge only 16%. However, if the consumer's country VAT rate is lower than that of the supplying EU business, the Australian operator will be at an advantage.

From a tax saving point of view, e-commerce companies might set up business establishments in low VAT member countries in order to benefit from the place of supply provision. This raises the question as to whether a server (or even a web site) can form a place of business or a fixed establishment under EU-VAT rules. This requires examination of the terms of 'place of business' and 'fixed establishment'.

Article 9(1) indicates that the place of supply of a service is where the supplier has its place of business or fixed establishment from where the service is provided. The place of supply of services under Article 9(2)(e) is the place where the customer has established his business or has a fixed establishment from where the service is supplied.

The Directive does not provide any definition of place of business or fixed establishment. It is not by chance that the Directive does not use the term 'permanent establishment' found in the OECD Model Income Tax Convention. While 'permanent establishment' is used for income tax purposes as a key concept in double tax agreements, the term fixed establishment and place of business serve as fiscal points of reference for VAT taxation.¹⁵

15 C Wäger and R van der Paardt, 'Is VAT (also) monopolized in Italy?' (2003) 1 *EC Tax Review* 22.

In this context it is important to remember that the nature of the two taxes is different. While VAT is a consumption tax levied at the place where goods and services are provided, income tax is due at the place where income arises. For example, if a business established in country A supplies services covered by Article 9(2)(e) to a business customer (B2B) located in state B, the services are subject to country's B VAT. In contrast, an enterprise situated in a contracting state deriving profit from its business done with a company in country B will pay income tax in its state of establishment.

Despite these conceptual differences, similarities between permanent establishment and place of business and fixed establishment do exist.

In the course of several judgments, the European Court of Justice has set out its understanding of what comprises place of business and fixed establishment. In the case *Berkholz v Finanzamt Hamburg-Mitte-Altstadt*,¹⁶ and later in *Faaborg-Gelting Linien A/S v Finanzamt Flensburg*,¹⁷ the European Court of Justice ruled that the place of the supplier's business is the primary point of reference. Other establishments are therefore only relevant where the supplier's statutory place does not lead to a rational result or creates a conflict with another Member State. Fixed establishment is a point of fiscal reference as for a place of business; however a place of business is taken into account as the primary consideration when tax authorities determine place of supply.

The *Berkholz* case illustrates these principles. The company owner Berkholz, with headquarters in Germany, provided the service of installing and operating gaming machines on board two ferries running between Germany and Denmark. The machines were maintained regularly by employees of the German company but without a permanent staff on the ferryboats. One question was whether the service provided by Berkholz was supplied from the company's office in Hamburg or from the boat itself, where the machines operated.

According to the European Court of Justice services cannot be deemed to be supplied at an establishment other than the place where the supplier has established its business unless that establishment is of a certain minimum size and both the human and technical resources necessary for the provision of the services are permanently present. Installation of gaming machines, that are maintained intermittently on board a seagoing ship, are not capable of constituting a business

16 C-168/84.

17 C-231/94.

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establishment, especially if tax may appropriately be charged at the place where the operator of the machines has its permanent business establishment.

In the *ARO Lease BV* case, the European Court of Justice further clarified what the necessary minimum level of permanent human and technical resources means in order to qualify as fixed establishment. To be treated, by way of derogation from the primary criterion of the main place of business, as the place where a taxable person provides services, 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.

However, the European Court of Justice acknowledged in the case *Customs & Excise v DFDS A/S*¹⁸ that an enterprise located in another member state and operating as agent for the resident company may be a fixed establishment from where the services are deemed to be supplied. DFDS, a tour operator with a registered office in Denmark, sold package tours through its English subsidiary DFDS Ltd, which acted as its general sales agent and booking office. An agency agreement was concluded between the parent company and its subsidiary. The wholly owned subsidiary was further obliged to obtain prior approval for any major contract and to consult the parent company in employment and marketing matters. The pivotal question for the European Court of Justice was whether the place of business (Denmark) or the place of the subsidiary (United Kingdom) was the primary point of reference for levying VAT. As the subsidiary operated as an agent of the Danish resident company, its place could only represent a fixed establishment of the parent company if it was dependent on its principal. There are various criteria that indicate the independence of an agent from its parent company, not discussed here; but the Court held that the agent had no effective independence in conducting its business.

Although the European Court of Justice has not yet had the opportunity to express its views on e-commerce supplies, these principles offer general guidance on the application of place of business and fixed establishment.

It is important to bear in mind, however, that Article 9 is designed to 'secure the rational delimitation of the respective areas covered by national value added tax rules by determining in a uniform manner the place where services are deemed to be provided for tax purposes.'¹⁹

18 C-260/95.

19 C-168/84.

Article 9 is more concerned with intra-community supplies than cross border services. The Directive's concept of place of business and fixed establishment is based on the notion that an enterprise is only capable of carrying business in a country by establishing a physical presence. It was designed at a time when physical economy predominated and most services were not capable of direct delivery from abroad.²⁰ In all its decisions, the European Court of Justice had to deal with an enterprise providing services from a location other than the place of the company's residence. For companies not having their seat in an EU member country, the point of reference can only be 'fixed establishment', since the place of business to which Article 9 primarily refers is outside the EU.

Electronic supplies can be performed without any kind of establishment in the EU. Article 9 did not foresee this possibility. Although a server might be a potential point of fiscal reference, the question whether it could constitute a fixed establishment cannot be answered accurately under this general premise.

As a server is computer equipment on which a web site, database or other digital information is stored, it follows that the installation of a server with a web site in an EU member country might constitute a fixed establishment if it meets the requirements set by the European Court of Justice. If the supplying offshore business owns and operates a server located in the EU and maintains it with its own employees, there is no reason why this 'server' will not constitute a fixed establishment for VAT purposes. However, this is unusual. It is more likely that the enterprise will conduct its business through a server without any personnel. The mere presence of technical infrastructure does not satisfy the concept of fixed establishment.²¹

As the *DFDS A/S* case shows, a separate legal entity acting as an agent for another enterprise may constitute a fixed establishment of that enterprise. Internet service providers who offer the service of 'hosting' web sites may consequently represent a fixed establishment of the enterprise that carries on electronic commerce through web sites operated by servers owned and maintained with technical and human resources by the internet service provider.

If we consider the principles of the *DFDS A/S* case in this context, the key issue when seeking to determine whether an internet service provider is an agency fixed

20 Richard Doernberg, Li Jinyan, Luc Hinnekens, 'Electronic Commerce and Multijurisdictional Taxation' (2001) *Kluwer Law International* 204.

21 Richard Doernberg, Li Jinyan, Luc Hinnekens, 'Electronic Commerce and Multijurisdictional Taxation' (2001) *Kluwer Law International* 416.

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establishment, will be the degree of dependence on the enterprise that conducted the business through the web site. In the *DFDS A/S* case, the agent was fully dependent on its parent company. It was subject to detailed instructions and comprehensive control by its parent company.

In most cases the internet service provider will be independent. It will not usually be involved in the contracts that are made by the enterprise with its online customers. It will have neither the authority to conclude contracts in the name of the enterprise nor will it be part of its service to represent the enterprise.²² The business of 'web-hosting' basically consists of providing 'storage facilities' for web sites. Thus it seems clear that neither an internet service provider nor a single web site constitutes a fixed establishment for offshore businesses.

GST and electronic supplies

Supply

Unlike the EU-VAT rules, the Australian GST is not drafted by reference to goods and services; rather the GST legislation²³ provides a broad definition of the term supply.²⁴ Section 9-10(1) of the GST Act states that 'a supply is any form of supply whatsoever'. Supply includes, under s 9-10(2):

- A supply of goods or service
- A provision of advice or information
- A creation, grant, transfer, assignment or surrender of any right
- An entry into, or release from an obligation
- Any combination of any two or more of the matter referred above.

Since the concept of a supply includes the concept of a right, then it is possible to consider that within one commercial transaction there might be more than one supply, although only one supply need be identified in determining GST liability. The sale of a bicycle, for example, is considered to be one supply for GST purposes. However, applying section 9-10 strictly, it is possible to identify several supplies of

22 Matthias Geurts, 'Server as permanent establishment' (2000) 28 (4) *Intertax* 174.

23 *A New Tax System (Goods and Services Tax) Act 1999* (Cth) ('GST Act')

24 Robert Deutsch, Mark Friezer, Ian Fullerton, *Australian Tax Handbook* 2004 ATP [63 080].

rights that might include rights derived from the contract and implied consumer rights.

This point is made because in the context of electronic commerce transactions, such a 'characterisation exercise' of supplies for GST purposes poses difficulties. For example, a law journal allows subscribers to access its web site and search for articles and cases. The database with its articles and other legal information is a provision of information and therefore a supply. The fact that the subscriber can use and print out the information from the database is an implied granting of an intellectual property right. Furthermore the subscriber and the law journal supplier both entered into an obligation to do something: the subscriber to pay the fees and the supplier to provide access to the database. Moreover, the whole supply might also be characterised as a service.²⁵

This raises two areas of difficulty: the characterisation question of supplies and second, the scope of the supply. Both issues are discussed with respect to electronic supplies below.

Connection with Australia

The connection with Australia is one of the elements to be satisfied before a supply is subject to GST. Section 9-25 of the GST Act defines when a supply is connected with Australia and distinguishes between types of supplies for the purposes of determining whether a supply is connected with Australia.

As electronic commerce transactions are supplies other than goods or real property, they are connected with Australia if either:

- (a) The thing is done in Australia
- (b) The supplier makes the supply through an enterprise that the supplier carries on in Australia.

The provision (section 9-25(5)(a)) defines widely since it requires that the 'thing' being supplied is 'done' in Australia. In Ruling GSTR 2000/31 the Commissioner expresses his view as to when the thing is deemed to be done in Australia. It is noteworthy that the Ruling does not address electronic supplies in particular. 'While the Ruling outlines the broad principles relating to all kinds of supplies

25 See s 156-5(2) and Jeff Mann, David Morrison and John Swinson, 'e-GST' [2000] 10 *Revenue Law Journal* 138-89.

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connected with Australia (other than telecommunications and financial supplies), it does not specifically illustrate how these principles apply to cross-border electronic supplies.²⁶

Nonetheless, the Australian Taxation Office does not exclude the application of principles set out in the Ruling as it does for telecommunications and financial supplies.

In analysing the wording of the provision - 'thing' refers to what has being supplied. The identification of supply determines the meaning of 'done'. Thus, what has being done depends on section 9-10 of the GST Act. It should be borne in mind that supply can be any form of supply whatsoever and according to section 9-10(h) any combination of any two or more listed supplies in (a) to (g) is deemed to be a supply. In fact, any supply may consist of several different types of supplies.

This becomes a matter of concern when it is necessary to identify the supplied thing in respect to connection with Australia. Is the thing connected with Australia when one part of the thing is done in Australia, but not the other part?

The Ruling refers in paragraph 61-73 to supply of services and supply of advice and information. If the thing is the supply of service, it will be done where the service is performed. No matter the location of the recipient, if the service is done in Australia section 9-25(5)(a) applies. Similarly the supply of advice or information is done where it is prepared, created or produced.

As the Ruling implies, the general principles are applicable to cross-border e-commerce supplies. Where the electronic supply is a provision of information (like a database, online newspaper etc) the place of supply is where it is prepared, created or produced. If the supplier were located outside Australia, the supply would not be connected with Australia. Where the supply is a service delivered electronically, it may be connected with Australia, if the service is performed in Australia. The Ruling gives an example of when a service is performed in Australia: an architect supplies a plan for a customer residing in Australia or outside. 'The service is done where the work is done, that is, where the plan is prepared or drawn.' At the end of paragraph 70 it is clarified that the delivery of the plan does not determine where the service is done.

26 GSTR 2000/31 para 6.

While the delivery of the architect's plan to the customer does not alter the fact that the service was performed at the desk of the architect, in the context of electronic supplies it would be expected that the aspect of delivery would be of paramount importance. However, under section 9-25(5)(a) – as understood by the ATO – electronic supplies are only connected with Australia when the digital information is transmitted from a location within Australia.

Further, a supply will be connected with Australia if the supplier makes the supply through an enterprise that the supplier carries on in Australia. A supplier carries on an enterprise in Australia if the supplier has a permanent establishment in Australia. The concept of permanent establishment is defined in section 6(1) of the Income Tax Assessment Act (1936) to which section 9-25(6) refers. Note that paragraphs (e), (f) and (g) of section 6(1) ITAA do not apply to the definition of permanent establishment for GST purposes. Hence, the scope of application for permanent establishment for consumption tax purposes is broader than the definition of permanent establishment for income tax purposes.

Section 6(1) of the ITAA provides that:

Permanent establishment means a place at or through which the person carries on any business and, without limiting the generality of the foregoing, includes:

- (a) a place where the person is carrying on business through an agent;
- (b) a place where the person has, is using or is installing substantial equipment or substantial machinery;

Although this definition is slightly different from the definition of permanent establishment in Australia's tax treaties and the OECD Model Tax Convention, GST Ruling 2000/31 states that: the underlying concept of connection to a permanent establishment is similar. Thus in establishing whether a supply is made through a permanent establishment it may be possible to draw some guidance from existing case law and commentaries such as the Commentaries on the OECD Model Tax Convention on Income and Capital.²⁷

First of all, permanent establishment must be a place of business. 'Place of business' requires a physical location such as a premises, office or room. Intangible property, therefore, is outside the scope of application. A web site for instance, that

²⁷ GSTR 2000/31 para 85.

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is the visible result of electronic data, cannot be a place of business.²⁸ However, the server, being a physical object, can constitute a place of business.²⁹ Apart from the possibility that a server may be a place of substantial equipment (section 6(1)(b)), the room where the server is located would satisfy the concept of place of business.

In addition, the OECD Model Tax Convention requires that the place of business must be fixed. This means that the business has to be established for a period of time before it might be regarded as a permanent establishment. By contrast, the definition in section 6(1) does not mention the term 'fixed'. It can thus be concluded that the place of business need not be established with any degree of permanence.³⁰ On the other hand it might be considered that the use of the permanent establishment includes per se the element of permanency. Nevertheless, in the context of electronic commerce, the absence of 'fixed' is of advantage as it renders the difficult permanency test irrelevant. It follows then that GST avoidance by the regular changing of a business server is therefore not possible.

The existence of a place of business alone does not constitute a permanent establishment. The business must be carried on through this place. This implies that the place of business must be at the enterprise's disposal, for example where the business owns or leases the place of business as sole occupant.

In the context of electronic commerce, if the enterprise stores its web site on its own server, the place where that the server is located could constitute a permanent establishment of the enterprise. However, if the web site is hosted by an internet service provider on a server which is at the disposal of the web-hosting provider, the enterprise will not have a permanent establishment through its web site.³¹ Under the OECD Model Tax Convention any business activities beyond a preparatory or auxiliary nature are sufficient for carrying on a business through this place of business. The definition of permanent establishment for GST purposes

28 OECD, *Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions* (2001) OECD 85.

29 Arvid Skaar, 'Erosion of the Concept of Permanent Establishment: Electronic Commerce' (2000) 28 (5) *Intertax* 189.

30 How Tan, 'Some Aspects of a Permanent Establishment in Australia' (1998) 1 (2) *Journal of Australian Taxation* 152.

31 Luc Hinnekens, 'How OECD Proposes to Apply Existing Criteria of Jurisdiction to Tax Profits Arising from Cross-border Electronic Commerce' (2001) 29 (10) *Intertax* 326.

does not however include this restriction. Thus, any difficulties of what the definition of preparatory and auxiliary activities comprises are circumvented.

Another issue for consideration is whether a server operating at a particular location might constitute a permanent establishment even though no personnel are required at that location. Unlike the concept of fixed establishment for EU-VAT purposes, the presence of human resources is not necessary for a permanent establishment. As far as the concept of agency permanent establishment is concerned, the principles mentioned above apply.

GST and cross-border electronic supplies

Electronic supplies provided from a supplier based in Australia are in general subject to GST because there is connection with Australia. This applies to both offshore and onshore supplies. However, electronic supplies to a recipient located outside of Australia may be GST free under section 38-190. Section 38-190(1) states that supplies of things, other than goods or real property are not subject to GST when made to a non-resident who is not in Australia when the thing supplied is done and:

- a) the supply is neither a supply of work physically performed on goods situated nor a supply directly connected with real property in Australia, or
- b) the non-resident acquires the thing in carrying on the non-resident's enterprise, but is not registered or required to be registered.

Hence, the export of electronic supplies to either business customer or private customer is not taxable. This is a fairly clear rule; unfortunately it is not so clear when there is an 'import' of electronic supplies. Unlike tangible goods which are taxable when entering Australia for home consumption (s 13-5), services will not be subject to GST. This seems to be inconsistent because the reason for not charging GST on exported services is that supplies are supposed to be consumed outside Australia. Therefore, from a consumption tax point of view it would be fair to impose GST on supplied services brought into the country.³²

Yet, the non-taxation is consistent with the GST connection rule. Intangible supplies like electronic supplies are supplied at the place where the thing is done, which means where the work is done, but not where it is delivered or used.

32 Aldrin De Zilva, 'E-commerce: tax and e-commerce: make hay while the sun shines' (2000) 34 (12) *Taxation in Australia* 652.

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In very limited cases, however, intangible supplies are subject to GST even they are not connected with Australia (s 84-5). It applies in business to business transactions and only if the Australian recipient is not entitled to offset input tax credits because the acquisition is for a non-creditable purpose. An example may illustrate this.

An overseas company updates the database by electronic means of a registered Australian financial institution. It uses the database in providing financial supplies. Under the general rules, the service would be not connected with Australia. Despite this, the service is subject to GST. By virtue of section 11-15(2), the service received is not solely for a creditable purpose because the service relates to providing financial supplies that are input taxed. Thus, the electronic service performed by the offshore company is a taxable supply. The GST is paid by the financial institution under the reverse charge mechanism.

The majority of electronic supplies provided by offshore suppliers however, are free from GST.

Core issues of electronically transmitted supplies

Characterization approach of e-commerce supplies

The EU-VAT rules classify e-commerce supplies as services. Whereas goods are defined as tangible property, services are deemed to be anything else other than tangible property. Services are therefore considered to be intangible property. While we have a relatively clear understanding of what tangible means, the notion and parameters of intangible remain nebulous.

By contrast, the GST Act does not explicitly classify electronic supplies as services; rather they are supplies other than goods or real property. Both the EU and Australian legislation, however, share a consideration of e-commerce supplies as something intangible in nature. Indeed, supplies transmitted electronically via the internet to the recipient are not tangible. A newspaper transmitted in electronic format such that it can be downloaded and read on a computer screen is not a tangible item like the paper version delivered to a home. The underlying question, therefore, is what determines that an item be treated as a tangible or intangible supply?

In some cases, it seems that the mode of delivery determines whether or not the supply is treated as a good (tangible) or as a service (intangible).³³ If computer software is supplied as hardcopy, it will be regarded as a tangible item. Conversely, the same software turns out to be a service when it is downloaded from the internet.

In other cases, however the channel of delivery is not decisive for characterisation purposes. A lawyer writing down a legal opinion on paper and sending it by post or via e-mail performs in both cases a service. It is said that the main feature of legal advice is the provision of a service. The piece of paper or the electronically submitted mail is simply the means of providing the service to the client.

To be literal, the supply of a legal opinion, in scientific terms, is simply a supply of bits of data. All electronic supplies are of a similar nature. The delivery via the internet is carried out by transmitting bits of information electronically to the customer's computer. However, neither the GST nor the EU-VAT rules have adopted such a definitional approach. Had the legislation done so, it would be necessary to conclude that the supply of a good is really a supply of atoms. Such a view is impractical and does not take into account the important fact (from a taxation point of view) that supplies are economic events and that taxation of the latter requires legal assessment.³⁴ This gives rise to the perpetual difficulty of distinguishing between a supply for tax purposes and a strict legal evaluation of the thing itself.

It is possible to consider that a supply of digitised products might be considered as a supply of goods. The example of the computer software either delivered conventionally or electronically shows that the content of both supplies is identical and a different legal treatment of the supply is therefore difficult to justify. It seems, therefore, that such electronic supplies can be treated as supplies of goods. This of course cannot be accepted since it disrupts the dichotomy between notions of tangibility and intangibility and further is difficult to apply to all electronic supplies.

Such considerations do not give enough attention to the fact that the aspect of electronic delivery constitutes a major part of electronic supplies. Whereas delivery plays a minor role in the supply of goods or physically performed services, e-

33 Richard Doernberg, Li Jinyan, Luc Hinnekens, 'Electronic Commerce and Multijurisdictional Taxation' (2001) *Kluwer Law International* 420.

34 Jeff Mann, David Morrison and John Swinson, 'e-GST', (2000) 10 *Revenue Law Journal* 167.

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commerce transactions are determined by their mode of delivery. Goods can be delivered or picked up by the customer. In either case, there is a supply of goods. Electronic supplies, however, are always electronically delivered. While the delivery of a good to a customer represents an additional service, the delivery by electronic means is part of the service.

In the *British Telecommunications* case³⁵ the question was whether the delivery of the car was a separate supply from the supply of the car. The Court held that the transport of the vehicle (supply of service) was to be regarded as incidental and ancillary to the supply of the car. However, the delivery element of electronic supplies could never be just incidental or ancillary. As a result, the characterisation of electronic supplies as a services makes sense and it is appropriate to treat them as services.

Scope of supplies

Consumption tax is imposed on commercial transactions of goods and services. However, the scope of the term 'supply' is not congruent with commercial transactions.³⁶ Transactions may often consist of several different supplies. Where supplies in one commercial transaction are identified for different VAT rates or exemptions and especially for cross-border transactions for different places of supply, the question whether these supplies represent an overall single supply or several distinct supplies becomes particularly relevant.

For instance, where computer equipment is offered together with an internet subscription or software is delivered on CD-ROM, but the inevitable updates that follow are digitally supplied.³⁷ In all these events, the issue of determining a single supply or a composite supply arises. Neither the EU-VAT Directive nor the GST addresses explicitly this topic. Guidance on how to define single and multiple supplies can only be derived from EU case law and for the GST, from the ATO's view set out in the GST Ruling 2001/8. The ATO agrees with the principles developed from 'overseas courts'.

35 [1999] 1 WLR 1376.

36 Jeff Mann, David Morrison and John Swinson, 'e-GST', (2000) 10 *Revenue Law Journal* 167.

37 Michael Massbaum and Klaus Eicker, 'The Proposal for an EC Council Directive regarding the VAT Arrangements Applicable to Services Supplied by Electronic Means' (2001) 29 (3) *Intertax* 91, 94.

In the *British Airways* case³⁸, the Court of Appeal held that the supply of catering was an integral part of the flight and therefore not distinguishable from the main supply.³⁹ The concept of the essential characteristics of a transaction may provide a dividing line between overall single supplies and supplies to be treated separately. However, this criterion is of limited guidance since the distinction is largely a matter of assessment and evaluation.

In a recent judgment concerning the treatment of composite supplies, the European Court of Justice has further evaluated when transactions comprising two supplies are to be regarded as a single supply for VAT purposes or as two independent supplies. In the case of *Card Protection Plan*,⁴⁰ an insurance company offered to its customers an insurance (VAT exempt) and a card registration service for a single price. The Court sets out that, in general, every supply must be regarded as distinct and separate.

However, the proper functioning of the VAT system requires assessment of supplies also from an economic point of view in order to prevent artificial results. Thus, the essential features of the transaction must be ascertained in order to determine whether a supply is separate and distinct or integral, ancillary or incidental to the other. A supply is integral to the principal supply if it is an intrinsic component of the whole thing that is being supplied. Incidental, would be a supply that naturally accompanies the main supply. A supply is ancillary if it does not constitute for customers an aim in itself, but a means of better enjoying the principal supply. For electronically transmitted supplies, the issue of defining the scope of the supply is exacerbated in the context of cross-border trade by potentially different applicable place of supply rules.

Take, for example, an Australian business that provides a package deal of legal or financial advice together with access to a subscription fee database containing

38 [1990] STC 643.

39 The European Court of Justice confirmed this approach in a broadly comparable case where the supply of meals on board a ferry running between Denmark and Germany was either to be considered as an integral part of the main transportation service or as a separate supply of goods. The European Court of Justice ruled that in order to determine whether such transactions constitute supplies of goods or supplies of services, regard must be had to all the circumstances in which the transaction in question takes place in order to identify its characteristic features. Restaurant transactions are characterized by a cluster of features and acts, of which the provision of food is only one component, and in which services largely predominate and therefore they should be regarded as supplies of services.

40 C-349/96.

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articles and newsletters on legal and financial matters. The place of supply under EU-VAT rules would be different, if separately assessed. Advice supplied to EU customers from businesses established outside the Community is taxable at the place where the supplier has established his business (Article 9(1)). Article 9(2)(e) does not apply since it covers only services provided to EU-business customers. The database access is a service listed under Article 9(2)(e), which is taxable at the place of the customer (Article 9(2)(f)). It is a matter of fact whether this package offer has to be regarded as two separate taxable supplies or of a principal and ancillary supply. Assuming there is one single supply - then the advice is principal and the electronic supply ancillary.

From a VAT cost saving perspective, non-EU businesses supplying services to EU customers are unintentionally encouraged to include ancillary e-commerce services so as to benefit from the general place of supply rule of Article 9(1). The risk of non-taxation is finally realized when the supply is tax exempt at the supplier's place of business. This is likely to be the case if an Australian company providing these combined services treats them as a single supply to a consumer residing in the EU. Although the supply does have a connection with Australia, it will be GST-free under section 38-190.

Place of consumption of cross-border electronic supplies

The OECD suggests that consumption tax should be levied at the place of consumption. Taxation in the jurisdiction in which consumption takes place promotes certainty and prevents double taxation or unintentional non-taxation. It provides a level playing field and is thus neutral within and among conventional and electronic forms of commerce.⁴¹

Consuming is the act of using something. Under a pure consumption test, goods and services would be regarded as consumed in the place where the customer actually uses the goods or services. The actual place of consumption could therefore only be identified, if the customer revealed the location of its consumption. Although some supplies can only be consumed at a specific location (hotel accommodation, hairdressing), in general it can be said that the act of consuming and the decision where the supply is consumed depends upon the consumer and can therefore be different from the place of acquisition.

41 OECD, *Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions* (2001) OECD 24.

Cross-border electronic supplies challenge, in particular, the notion of place of consumption. Owing to portable computer and global internet access, consumption can virtually take place in any part of the world. Therefore a pure consumption test is impracticable.

No VAT jurisdiction, however, refers to the actual place of consumption. Where tangible goods are delivered to a customer, the place of consumption is based on the recipient's address. In this case, the place of delivery is assumed to be the place of consumption. While the place of delivery of tangible goods will likely be the place where the items are consumed, it cannot be assumed to the same extent for an intangible supply.

Two kinds of services need to be distinguished. Services where performance and consumption takes place at the same location and services where performing and consuming do not necessarily take place at the same location. Taking the aspect of performance as a fiscal point of reference, services capable of being consumed at another location would not be taxed at the place of consumption. As electronic supplies can be consumed globally, the place of performance does not seem to be appropriate.

However, neither the place of performance nor the place of delivery provides a reliable means of determining the actual place of consumption. Electronic supplies have the peculiarity that they are performed and then delivered. Both aspects are necessary for an electronic supply with the result that there are two possible taxable places: the place of performance and the place of delivery.

For cross-border electronic supplies, taxation at the place of performance is origin based and increases the risk of double or non-taxation. In online transactions the place of delivery is the customer's internet address which does not reflect either its actual place of residence or the actual place of consumption.

Nevertheless, a practicable approach in determining the place of delivery might be the recipient's resident address.

In the case of electronic supplies, the determination of the consumption place in fact consists of twin assumptions. The place of consumption is assumed to be the place of delivery and the place of delivery is assumed to be the customer's residential address. This is certainly 'not the most theoretically pure definition of place of consumption',⁴² but the most reasonable and practicable solution.

42 OECD, *Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions* (2001) OECD 31.

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Tax collection mechanism

The collection of consumption tax within the context of cross-border electronic commerce constitutes a challenge for tax administration since being 'borderless, paperless and often anonymous'. Effective tax administration needs a necessary minimum of information to assess tax liability. Identification of a taxable person and verification of the transaction are imperative to enforce collection. From a tax policy point of view, it would be incomplete to regulate taxation of e-commerce supplies without addressing the enforcement issue.

Two tax collection mechanisms are commonly used in consumption tax systems for intangible supplies: registration and reverse charge. Under the reverse charge mechanism the recipient becomes liable for VAT. Instead of the supplier, the customer is obliged to remit the applicable VAT directly to the domestic tax authority. The reverse charge currently applies only to business to business transactions.

The registration scheme requires non-resident businesses to register in the jurisdiction where the supplies are made.

In the context of e-commerce supplies, the EU adopted the reverse charge mechanism for business to business transactions and the registration scheme for transactions between businesses and private customers.

While the reverse charge has proven to be a successful collection method and simple to administer, the feasibility of the system for non-resident businesses supplying domestic consumers is questionable.⁴³ The registration method for B2C transactions has been criticized for imposing a substantial compliance burden on non-resident businesses and as being detrimental to the development of cross-border e-commerce transactions. Considering these registration difficulties, the OECD proposed measures to minimise the compliance burden. Electronic registration and the use of tax thresholds was recommended as well together with electronic returns. The OECD states that a registration threshold amount would ease compliance by excluding those companies supplying small or occasional amounts.⁴⁴

43 Richard Doernberg, Li Jinyan, Luc Hinnekens, 'Electronic Commerce and Multijurisdictional Taxation' (2001) *Kluwer Law International* 565.

44 OECD, *Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions* (2001) OECD 31.

The EU did not adopt a threshold provision because it would favour non-EU suppliers against EU internet businesses that are not subject to a threshold and so create an unequal playing field. The threshold could also be used to avoid tax as the turnover amount cannot be audited adequately.

There has been some debate about the effectiveness of the registration regime, particularly whether the registration requirement is more symbolic than a successful attempt to collect tax. Supplies electronically delivered by a business operator established outside the country where the customer resides, remain private. E-commerce makes it currently impossible for tax authorities to obtain knowledge of what, where and when taxable transactions took place.⁴⁵

During to the difficulties in monitoring registration obligations, it is uncertain whether this tax collection mechanism serves its purposes of raising revenue and establishing competitive neutrality between non-resident and resident e-commerce suppliers.⁴⁶

Nevertheless, it would be unacceptable to the EU to adopt a position as the ATO currently does: 'To date, no revenue authority has found a practical method for collecting consumption tax on the third categories [intangible property to private consumers] and Australia's GST does not presently seek to do so.'⁴⁷

A well-balanced tax policy must include the interest of those taxpayers complying with their tax obligations. The European Commission has clearly stated that businesses meeting their tax obligations at least need reassurance that their tax authorities will take steps against competitors failing to comply. Despite the principle that the power of enforcement and execution ends at a country's border, non-compliance will lead to an economic and legal risk even for operators established outside the country. Non-compliance identified by tax administrators ought to result in the usual imposition of penalties, interest charges, tax debts and possibly criminal prosecution.

45 Jinyan Li, 'E-Commerce Tax Policy in Australia, Canada, and the United States' (2000) 6 (2) *UNSW Law Journal Forum* 40, 45.

46 Michael Massbaum, and Klaus Eicker, 'The Proposal for an EC Council Directive regarding the VAT Arrangements Applicable to Services Supplied by Electronic Means' 2001 29 (3) *Intertax* 91, 94.

47 Australian Taxation Office, *Tax and the Internet: Second Report* (1999) para [7.3.12.]

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The impact of the requirements for non-established businesses to register and to account for VAT should not be underestimated.

'Trading systematically with the European Union on a basis which is outside the law is likely to cause difficulties in obtaining an unqualified audit or clear prospectus, so that whatever the difficulties of enforcement, a respectability factor comes into play. [...] There will always be niche players moving in and out of the market seeking advantage who may well escape detection and avoid contact with the EU-tax authorities. But trading in a systematic way with final consumers in the Community is in the long run likely to be a recipe for disaster once the new rules are in force.'⁴⁸

Indeed, well established internet businesses could not afford to operate beyond the law. They have a public reputation to protect. 'Small dotcoms', on the contrary, are likely to be less concerned about their image and will try to extract advantage.

EU-VAT and GST

The EU-VAT rules may serve as a model, if the amended provisions are transferable to the GST system. Both the EU and Australian legislation differ in several aspects. While the GST has a more comprehensive approach, the EU-VAT rules are detailed. An important difference, for example, is the concept of territory nexus for supplies.

Despite these differences, both laws are conceptually similar and seek to tax supplies at their place of consumption. This aim is fully achieved for goods. For intangible supplies, neither the EU-VAT nor the GST provides consistent regulation. The EU has however remedied this deficiency for electronic supplies.

Proposed amendment to the GST

The ordinary rules of the GST do not provide for economically equivalent treatment of electronic supplies. While electronic supplies by an Australian based business to a consumer in Australia is subject to GST, non-Australian suppliers are able to offer their service at lower prices, since they do not have to charge GST.

48 Richard Doernberg, Li Jinyan, Luc Hinnekens, 'Electronic Commerce and Multijurisdictional Taxation' (2001) *Kluwer Law International* 563.

To provide parity between Australian suppliers and offshore suppliers, section 84-5 should be amended so as to capture offshore electronic supplies, business to business and business to consumer.

Although it is arguable that electronic services supplied by an offshore business to an Australian recipient are not connected with Australia, practically it should be assumed that there is no connection with Australia.

An amendment of the connection rule for intangible supplies is not recommended since it would alter the whole GST system. In section 84-5, it is suggested that, in the absence of a separate provision, offshore suppliers would enjoy a price advantage over Australian based suppliers. The aim of section 84-5 is to re-establish a level playing field between onshore and offshore suppliers and therefore taxes offshore electronic supplies by virtue of a special rule.

The EU – VAT rules would work adequately in Australia to determine when a recipient consuming electronic services is deemed to be located in Australia and which tax collection mechanism should apply for B2B and B2C transactions.

Conclusion

The EU-VAT rules concerning electronic supplies are straightforward and in line with the principles agreed within the framework of the OECD. The ‘wait and see’ approach of the ATO results in revenue losses and is detrimental to Australian e-commerce businesses.⁴⁹

It is sufficient and appropriate to qualify all electronic supplies as services. The regulations for the enforcement of offshore supplier might not be the most effective, but in the circumstances are the most practical means around the difficulties.

As an OECD member country, Australia should implement the recommended regulations on cross-border electronic supplies. To this end the EU-VAT rules could serve as a model.

49 Ian Tunstall, ‘E-Commerce: The Implications for the Law’ (Report 7 - Taxation and the Internet) (2003) *Lawbook* 3.