Position paper

ETNO Reflection Document on the EU Green Paper on the future of VAT

May 2011

Executive Summary

- VAT should be charged by supplier irrespectively – wherever the business-to-business (B2B) or business-to-consumer (B2C) customer in the internal market belongs. Input VAT should be recovered in country of customer -- as in ordinary tax returns. VAT revenue to be distributed among member states should be based on macroeconomic data.
- The increasing burden on tax payers to operate the tax as the internal market evolves should operationally be shifted from tax payer to tax authorities in order to maintain a sustainable tax system.

Background - introduction

ETNO represents telecommunication companies throughout Europe and in all EU Member States providing a number of different services from traditional fixed line telecommunication services to mobile telecommunications, content provision and internet service providers.

We consider the EU Commission Green Paper concern basically is how member states need to maintain fiscal sovereignty aligns with EU basic principles for an internal market, with minimum obstacles for consumers and traders to use and take advantage from.

A starting point for ETNO is that a sale between EU countries should be treated most similar as a domestic sale. Furthermore that a sale within the EU at least should be equal, or better be less burdensome, to handle correctly than for 3rd country transactions.

From a VAT theoretical point of view, the EU as a single market and third countries exempt, the destination principle is applied within the EU. The matter of fiscal sovereignty of each country disturbs the naming of the principle. It is technically more correct to name the principle as an "adapted destination" principle – as long as the EU countries do not come into agreement with input tax deduction and a clearing mechanism. A "tax collection origin principle" for all transactions regardless of status of customer is feasible and less burdensome than local tax declaration in EU country where customer belongs. A VAT clearing system to distribute VAT collection should be based on macroeconomic data (not reliant on recapitulative statements). This means that VAT revenue is distributed between governments. The burden for operation of the tax on an EU level is shifted from tax payer to tax authorities. The complexity of tax system is reduced and an operating internal market is supported.

From business point of view, and eventually consumers, the internal market perspective precede government requirement for fiscal sovereignty. If for example differences in VAT rates require special arrangements for supplies of services made at distance for local consumption, and a single VAT rate may solve a VAT arbitration problem, the single VAT rate is to prefer compared to supplier liability to apply local VAT rate and reporting requirements even they are One Stop Shop.

For telecommunication services in particular it may seem as a paradox that they by nature are supplied at distance, but require a local establishment in each country due to each country spectrum control and local government licenses. This matter distinguishes the telecommunication sector from suppliers of other electronic services. In principle, if PAN European telecommunication licences would have been available, and a telecommunication company could operate with branches through Europe, the number of VAT transactions would be dramatically reduced.

Based on this introduction our answers to questions are perceived as long term ideal goal rather than operating short term realistic reply. In the context of the Green Paper we trust that our point of view provides value in further considerations.

ETNO reply to EU COMMISSION QUESTIONS

Q1. Do you think that the current VAT arrangements for intra-EU trade are suitable enough for the single market or are they an obstacle to maximising its benefits?

It follows from our introduction that we do not consider current VAT arrangements suitable for a single market. We recognise that it in best case is long-term realistic that governments give up fiscal sovereignty, to be dependent on a clearing mechanism based on macroeconomic data for tax revenue on local consumption.

Q2. If the latter, what would you consider the most suitable VAT arrangements for intra-EU supplies? In particular, do you think that taxation in the Member State of origin is still a relevant and achievable objective?

ETNO believe that VAT should be charged by supplier at rates set in the country where his business, providing the supply, is established regardless of legal status and location of customer. The destination principle to be applied in country of customer either by recovery of input VAT in ordinary VAT return (no VAT refund application) or non-recovery for non-taxable persons – with clearing mechanism for taxing consumption locally. The clearing mechanism should, as mentioned in the introduction, be based on macroeconomic data, not on recapitulative statements.

Electronic services/other services that are capable of supply from a remote location (this includes telecommunication services) should receive same VAT rate, or eventually a very narrow VAT rate band which may be taken into macroeconomic consideration when distributing revenue. The implementation of Directive 2008/8/EC from 1 January 2015 might eventually be cancelled.

As VAT is charged on cross border sales within the EU, bad debt relief will require common regulation in all EU countries (see also the comment to Q10)

Such integrated VAT system supports the functioning of the internal market. It could be underpinned with a real time central VAT monitoring database – see Q 30.

As ETNO has taken a long term goal as the point of departure for our reply, we at the same time would make a comment that business experiences with IT-related projects and demands coming from the tax authorities are negative. E.g. recapitulative statements (required before an invoice is issued), with respect to Germany an electronic balance sheet that requires a lot of data with the objective of reconciliation of the VAT accounting. A real time VAT monitoring database must function at own basis, easy to implement as part of standard business purposes. Burdensome additional clarification questions from tax authorities to business will not meet the objective of real time monitoring.

Q3. Do you think that the current VAT rules for public authorities and holding companies are acceptable, particularly in terms of tax neutrality, and if not, why not?

A general remark is made for public authorities. VAT exemption should be restricted to charges for authority decisions and not public bodies' services that is a supply for consideration (but not merely partly a refund of costs).

One obstacle that we do not consider to be compatible with the VAT neutrality principle is the dealing with holdings that are integrated in the corporate group structure for business-related reasons and that are denied input tax deduction. There are many business-related and commercial reasons to bring an intermediate holding into the corporate structure, something that is currently penalized by denying input tax deduction for the holding even though without this intermediate holding the input VAT were deductible at the level of the parent company or subordinate holding company.

Moreover, a holding company tax cost is also a matter outside a corporate group. It may therefore be considered holding companies to be treated according to underlying operating business, irrespectively whether the holding is within a group of companies or not. The holding therefore may be considered as a business operation (taxable or exempt) or a passive investment depending on basis for and nature of holding.

Q4. What other problems have you encountered in relation to the scope of VAT?

No answer.

Q5. What should be done to overcome these problems?

For holding companies a VAT group registration could be considered, with measures for proportional input VAT deduction based on activity in companies that are held operational or as a financial investment. Proportional input VAT calculation to be made irrespectively whether companies that are held are based in EU or third country.

Q6. Which of the current VAT exemptions should no longer be kept? Please explain why you consider them problematic. Are there any exemptions which should be kept and, if so, why?

Financial services are still under discussion in the EU. The payment part of financial services where no particular financial risk is involved should not be exempt.

Example: Offering credit earning interests when goods and services are supplied and paid for with credit card is a part of credit card business, while aim is not financial for telecommunication business when subscribers use mobile phone (SIM card authentication) so that goods and services can be supplied and paid for by mobile subscription (prepaid or postpaid subscriptions). ETNO would like to point out our letter of 3 September 2008 to the EU Commission (enclosed) in this respect. We might add that mobile payment to various extent integrate/bundle with marketing the services, ordering services, supply of services – and payment of services. Exempting some (financial) part of a service is not advisable.

Even ”white washing” requirements and customer protection has imposed certain obligations on telecommunication companies in this respect (e-money and e-payment directive), they should not be considered as VAT exempt for “mobile payments”.

Q7. Do you think that the current system of taxation of passenger transport creates problems either in terms of tax neutrality or for other reasons? Should VAT be applied to passenger transport irrespective of the means of transport used?

No answer.

Q8. What should be done to overcome these problems?

Generally payment services should not be exempt, only the subsequent credit element. However, exemption may be accepted if provided by financial institutions, but with an option for financial sector to tax.

Q9. What do you consider to be the main problems with the right of deduction?

ETNO members have experienced that some countries are too strictly formal with respect to requirements to be contained in invoices for input VAT recovery. When such strict formal requirements (in tax audits) are combined with a refusal to retroactively adjusting invoices that contain insignificant formal errors (and combined with tax interest claim), this conflicts with purpose that input VAT shall be lifted in a chain of supplies.

This violation of VAT system neutrality has not been solved by applying the judgment passed by the European Court of Justice regarding the "Pannon Gep. Case". National authorities do not apply the judgment in the sense of a permitted, retroactive invoice adjustment. National authorities rather keep to a strict, basic regulations set forth in the judgement passed by the European Court of Justice regarding the "Terra Baubedarf case".

This inadequate situation might worsen from 2015 when (through not applying the country-of-origin principle) telecommunication companies must address formally standardized invoices to private customers based in another EU country than the supplier

Another matter experienced is that if self bill arrangements are agreed, but that the supplier does not not fulfill the obligation to report and pay output tax, input tax recovery is denied. This is not according to the Directive. A guiding implementation from EU Commission is expected. We comment that the document certainly should be in the format of a self billed invoice and not a credit note.

Q10. What changes would you like to see to improve the neutrality and fairness of the rules on deduction of input VAT?

Member States individually should not be allowed to determine conditions for reduction of tax accordingly in cases of cancellation, refusal or total or partial non-payment, or where the price is reduced after the supply takes place. This must be decided at EU level.

The background for this suggestion is that ETNO members have experienced that some Member States set conditions very restrictive, or unreasonable in terms of complexity (especially in case of many, small individual amounts, adding up to a large sum). Principle of neutrality is violated.

For cancellations credit notes with retroactive invoice adjustment should be accepted for taxable amount. Non-payments that are reasonably enforced should be accepted as bad debt with effect for the proportional output VAT.

Q11. What are the main problems with the current VAT rules for international services, in terms of competition and tax neutrality or other factors?

Provided that international services are automated electronic services (that includes telecommunication services) – capable of supply from a remote location, the main problem is that EU VAT on consumption is particularly reliant on voluntary compliance by non-EU suppliers. This means when supplied to any customer that does not have a liability to account for transactions (in practise private consumers).

In a global market where customers can purchase automated services on-line, an additional VAT cost distort level of competition. Telecommunication companies with a local network cannot relocate like e.g. IP telecommunication providers can. Then a situation may be faced that networks are owned by single purpose companies that sell capacity in bulk to third country telecommunication suppliers that serves consumer markets.

In terms of international services, ETNO considers the following to pose a significant problem for the Telecommunication industry:

-in general, service providers will be forced to deal with local registration regulations when providing digital B2C services in a third country. This principle, which the national finance authorities of the EU countries still consider to be lacking in terms of execution when it comes to foreign, third country companies with business activities in the EU, can also lead to problems for TC companies based in the EU. The EU's strict approach in this matter also results in expansive EU Telecommunication companies having to conduct a review of their own registration requirements in the relevant third country. A break with this principle would be welcome, since ETNO feels that the EU finance authorities are suffering deficits in enforcing this principle and that this principle can cause compliance problems for internationally expansive Telecommunication companies. To this extent, ETNO does

not consider the solution to be increased international coordination but rather a generally more lenient taxation of services that are provided electronically.

ETNO does not consider it sustainable for the EU to rely on regulations (even one-stop-shop) imposing VAT at local rate.

Q12. What should be done to overcome these problems? Do you think that more coordination is needed at international level?

The short term goal will be to harmonize rates in the minimum band for standard rated services (e.g. 15% as for Luxembourg today). The consumer markets must be monitored regarding level of supplies from third countries and third country supplier's compliance with respect to payment of EU VAT. If EU suppliers still would suffer from distortion of competition, it may to be considered whether electronic services are suitable as objects for imposition of consumption tax.

If a telecom provider is acting in own name and invoices local VAT on these services, some Member States still require local VAT registration for a content provider resident outside the EU. It should be provided a Commission best practice guidance that this is not a requirement.

Q13. Which, if any, provisions of EU VAT law should be laid down in a Council regulation instead of a directive?

All legislation may be laid down in regulations.

Q14. Do you consider that implementing rules should be laid down in a Commission decision?

Yes, such secondary legislation should efficiently be Commission decisions.

Q15. If this is not achievable, might guidance on new EU VAT legislation be useful even if it is not legally binding on the Member States? Do you see any disadvantages to issuing such guidance?

See Q 13 and 14 that presupposes that Member States do not keep current sovereignty on VAT. If so, guidance (that is not implementing

rules) may be supplied by local tax authorities, but subject to observation and eventually amendments by Commission.

Q16. More broadly, what should be done to improve the legislative process, its transparency and the role of stakeholders in the process, from the initial phase (drafting the proposal) to the final phase (national implementation)?

Continuing current practise by Commission.

Q17. Have you encountered difficulties as a result of derogations granted to Member States? Please describe these difficulties.

Difficulties are encountered for some countries (Italy, Austria, Germany, UK) in implementing exceptions that have been passed for the domestic delivery of devices and microchips. These are supposed to be implemented in accordance with the reverse charge procedure and possibly in combination with specific delivery thresholds. This will result in significant cost-relevant expenses for telecommunication companies for implementation, and significant legal insecurities and delimitation problems (definition of a device, identifying and monitoring delivery thresholds, etc.) will remain at the expense of the taxpayer. Such delimitation problems also make it more difficult to account for revenue, at least in Germany, when a telecommunication company provides construction services to another construction company that also need to be accounted for in accordance with the RC procedure. The many exceptions created by local RC procedures further complicate the VAT system, preventing transparency, which means that general taxation in accordance with the country-of-origin principle should be favoured.

Q18. Do you think that the current procedure for granting individual derogations is satisfactory and, if not, how could it be improved?

In principle no derogations should be allowed; or just very few, if allowed. If derogations are introduced they should be valid only temporarily.

With regard to the use and enjoyment provisions the criteria should be defined within the Directive rather than being left to the individual member states.

Q19. Do you think that the current rates structure creates major obstacles for the smooth functioning of the single market (distortion of competition), unequal treatment of comparable products, notably online services by comparison with products or services providing similar content or leads to major compliance costs for businesses? If yes, in what situations?

The current rate structure creates obstacles. Different rates should only be allowed if goods and services by nature are supplied locally for local consumption such as restaurant services, services that require deep local competence, local construction work etc. (Local competence does obviously not include national language.)

In order to create a more transparent, more effective VAT system, we need to favour tax rates that have not been reduced or consist of only a limited number which are reduced. This minimizes delimitation problems when selling products and services. Particularly when dealing with more complex, combined services, many questions are currently being raised regarding determining location, service standardization and the application of tax exemption in the EU's current VAT system with a very narrow tax basis. The number of these questions could be reduced by widely applying harmonized tax rates.

Q20. Would you prefer to have no reduced rates (or a very short list), which might enable Member States to apply a lower standard VAT rate? Or would you support a compulsory and uniformly applied reduced VAT rates list in the EU notably in order to address specific policy objectives as laid out in particular in 'Europe 2020'?

In order to harmonize tax rates we would support a specific reduced VAT rates list compulsory.

Q21. What are the main problems you have experienced with the current rules on VAT obligations?

Complexity, amount of work to account and comply with reporting obligations and tax audits. This certainly will increase with 1 January 2015 cross border B2C telecommunication supplies. ETNO believe un foreseen issues may add to complexity.

Q22. What should be done at EU level to overcome these problems?

Due date for recapitulative statements should be invoice date instead of date of supply.

General rule in B2C transactions should be taxation at origin, no different rule for telecom services from 2015.

Q23. What are your views particularly on the feasibility and relevance of the suggested measures including those set out in the reduction plan for VAT (N° 6 to 15) and in the opinion of the High Level Group?

With respect to reducing red tape, ETNO would welcome initiatives that would reduce the administrative burden on companies in order to be compliant with their VAT obligations (e.g. abolishment of EU acquisition listings in some EU Member States, etc).

As a general remark, ETNO believes however that the main simplification in VAT formalities should be the result of a simplification of the underlying VAT rules, and not just of the rules on the VAT formalities which are to be complied with. By drastically simplifying the VAT system as a whole, companies should normally have less difficulties in complying with VAT legislation and should experience a reduction in red tape, apart from any measures taken specifically related to reducing the VAT compliance requirements.

Q24. Should the current exemption scheme for small businesses be reviewed and what should be the main elements of that reassessment?

No answer.

Q25. Should additional simplifications be considered and what should be their main elements?

A general remark is that any new simplification creates unforeseen complications.

Q26. Do you think that small business schemes sufficiently cover the needs of small farmers?

No answer.

Q27. Do you see the one stop shop concept as a relevant simplification measure? If so, what features should it have?

ETNO do not consider this as a relevant simplification unless there will be only a single VAT rate within the EU. One possibility could be the introduction of a flat rate charge especially for telecommunication services. With regard to the new B2C rules from 2015 the major problem will be the implementation of 27 VAT rates within the billing systems, and the fulfilment of the various invoice requirements. On this background the mere payment simplification seems rather negligible.

Q28. Do you think that the current VAT rules create difficulties for intra-company or intra-group cross-border transactions? How can these difficulties be solved?

Yes, difficulties may arise from intra-group cross border transactions. They could be solved by the acceptance of cross-border VAT-groups. (Reference is made to the proposals for a common consistent tax base for direct taxes.)

Q29. In which areas of VAT legislation do synergies with other tax or customs legislation need to be promoted?

No answer.

Q30. Which of these models looks most promising in your view and why, or would you suggest other alternatives?

Real time VAT monitoring database at PAN EU level. Real time monitoring should be carried out on a continuously 24 hour basis in co-operation by Member States. The monitoring body should be organized multilaterally between Member States, not left to each national tax authority to implement. See reply to Q2.

Aside from model 4, we tend to be very critical of the models for more efficient VAT collection suggested in sub-section 5.4.1.

In model 1 it is not possible for companies to conduct checks comparing its own accounting records and bank payments, particularly when dealing with international payment transactions with foreign banks. There are many factors to consider, particularly in view of mass services involving millions of end customers, that make using the proposed model 1 entirely impossible. These include bonuses, discounts, problems due to late payment or failure to pay invoices or invoice deductions.

We therefore say "no" to question 31.

In model 2, the high data volume, the impossibility of taxpayers making subsequent corrections that are absolutely necessary as well as data privacy issues all speak against the possibility of transferring all of the data. TC companies in particular write millions of invoices each month, and we have to assume that no local finance authority will be able to process such a high data volume and that the standard that has been set for taxpayers in terms of the expense and procedures they are expected to cover is clearly too high.

In model 3, we also consider the high data volume and further parallel accounting activities with significant additional costs for the taxpayer to be unreasonable. Finance authorities already have automated access to the accounting systems, which means that finance authorities can already access the data they need without a problem.

The only model that seems realistic is model 4 if it is understood in terms of a real "tax partnership" and also brings taxpayers advantages such as less administrative expense as well as greater legal security and reliability.

Based on the above, models 1-3 should be rejected as being unreasonable in terms of content and not feasible in terms of processes.

Q31. What are your views on the feasibility and relevance of an optional split payment?

It will increase complexity to bookkeeping processes that integrates VAT. An optional split payment should eventually be restricted to be optional between SME's and supplies commented on in answer to Q19.

Q32. Would you support these suggestions to improve the relationship between traders and tax authorities? Do you have other suggestions?

ETNO basically welcomes the suggestions that have been made and hope that a fast, mandatory information channel that is free of charge for all taxpayers will be established since "third party funds" are being collected from taxpayers and managed even though the costs that arise for taxpayers as a result of this are not being refunded.

When it comes to developing tax partnerships it should be possible for tax authorities and taxpayers to clarify problems and questions in a non-bureaucratic fashion.

We are sceptical of the last suggestion made regarding adjusting the IT systems of tax authorities and companies to the extent that it would lead to additional administrative obligations and costs for companies.

For the purpose of a legal security for cross border transactions we would appreciate the implementation of an EU authority being in the position to release rulings covering all Member States.

Q33. Which issues, other than those already mentioned, should be addressed in considering the future of the EU VAT system? What solution would you recommend?

Reference is made to the introduction part of our reply to the Green Paper.