World Wide VAT forum: E-commerce

Tom Borec, Michaela Merz and Andras Salanki
PwC, Switzerland

This article is based on the fourth of PwC Switzerland's 2012/2013 World Wide VAT international VAT forums and discusses the VAT implications businesses may face in the rapidly developing area of e-commerce.

I. Introduction

The fourth workshop of PwC Switzerland's World Wide VAT international VAT forum was held in Zürich on April 9, 2013. The main topics included the increasing intensity of the global phenomenon of internet-based trade, the upcoming VAT changes in the European Union effective as of January 1, 2015 relating to the place of supply of certain e-services provided to private customers, as well as an international outlook.

II. Increasing importance of e-commerce

Internet-based supplies of goods and services are part of almost everyone's daily routine. This trend is also obvious from all available statistics and forecasts, which suggest that the share of e-commerce trade will significantly increase in all geographical regions of the world in the next five years and beyond. While the internet as a distribution channel opens new opportunities for all sorts of businesses, traders must also be aware of the corresponding VAT (and customs) implications that can make or break the implementation of even the most brilliant business ideas.

III. The 2015 VAT changes in the European Union

Tom Borec is a Senior Manager, **Michaela Merz** is a Partner and **Andras Salanki** is an Assistant Manager in the VAT department of PwC in Zurich/Switzerland

As of January 1, 2015, the place of supply of electronically supplied services ("e-services"), telecommunications and broadcasting services, when supplied to non-taxable (B2C) persons within the European Union, will for all vendors shift to the place where the customer is established. This means that the location of the service providers, be it in Europe, in the Americas or in Asia, will no longer determine the VAT treatment and as such EU and non-EU service providers are going to play by the same rules.

Technically it will require service providers to register for VAT purposes in every EU Member State in which they have B2C customers and charge VAT at the locally applicable VAT rate. Considering the worst case scenario and also taking into account Croatia's EU accession on July 1, 2013, it may lead to 28 different VAT registrations with 28 different VAT compliance obligations.

However, EU legislators also realised this potentially enormous administrative burden and as an optional simplification to the above rule, the so-called "Mini One Stop Shop" (MOSS) scheme will be introduced. Subject to certain conditions, this option will enable businesses to register for VAT in an EU Member State of their choice and file quarterly electronic VAT returns. VAT will still need to be accounted for at the applicable VAT rates in the country where the customers are located, but the VAT filing and payment obligation can be discharged via a single registration. It should be noted that MOSS may only simplify EU VAT registrations, but country-specific tax rules will still need to be checked for the rest of the world (e.g. Switzerland, US, Malaysia).

In addition to the VAT registration, it is equally important to know who B2C and B2B customers are and where are they are located, as this information is key to determining the VAT treatment.

For VAT purposes, B2B customers are those businesses that are registered for VAT purposes as well as all foreign clients that would have been registered for VAT if the domestic rules would apply to them. All other clients are B2C customers. Of them, the largest group will more than likely be private individuals who are buying games, software, downloading music, films and any other digital content online. However B2C customers can also include: non-VAT registered small businesses, holding companies, financial institutions, associations, federations, clubs, charities,

foundations, unions, NGOs, public bodies, political parties, etc. All these customers will be deemed B2C if they are not registered for VAT purposes.

The biggest challenge however is to collect (and retain) reliable information for establishing the B2C customers' location and verifying the applicable VAT treatment. In its proposal[1], the EU Commission provides guidance on what can be used as location evidence. This can be split into two categories: "refutable" presumptions, which can be used unless contrary information is available, and "irrefutable" presumptions that are mandatory to apply. Refutable presumptions will deem the place of supply of telecom, broadcasting and e-services supplied via a fixed land line and for delivery to the address where that fixed land line is installed. For orders via mobile phone, the place of taxation is deemed to be the country as identified by the country code of the SIM card. If a special device or a viewing card is used (e.g. digital TV), the place of taxation is the location where the viewing card has been sent to or the device has been installed.

Irrefutable presumptions will deem the place of supply of similar services provided at a telephone booth or kiosk, wifi hotspot, internet cafe, restaurant, hotel lobby and so forth (except when such services are provided on board a ship, aircraft or train). In the case of prepaid SIM cards, the place of taxation is identified on the basis of the country code of that SIM card.

The proposal also provides an open-ended list of potential location evidence, the detailed analysis of which would exceed the limit of this article. In brief however, these include among other things the billing address of the customer, bank details such as the place where the bank account used for payment is located, the internet protocol (IP) address of the customer's device and any other commercially relevant information.

According to the proposal, at least two separate, not-contradictory pieces of evidence will be required to determine the location of the customer. However, it remains to be seen how many pieces of evidence will be necessary in the event that some of them are contradictory – i.e. will in actual practice two out of three be sufficient in all cases or will additional evidence be required?

In summary, being fully compliant with the aforementioned rules requires advance planning and timely implementation. No doubt, large players have enough in-house tax experts to deal with this matter, but small and medium-sized businesses will have to ensure the same level of compliance with much fewer assets at their disposal – thus they will likely be hit hardest by these rules. It should also be borne in mind that local tax authorities will have the technical resources to block non-compliant traders from their jurisdiction. Therefore, being compliant will also help businesses to maximise their profits. With this in mind, PwC investigates available options and technological solutions to make life easier for businesses.

At the end of the day, a decision needs to be made between keeping the tax compliance obligations light or creating a pleasant customer experience in more than one country. However, the current worldwide set up of VAT (and similar consumption-based taxes) does not allow both options to coexist.

IV. E-trade of goods

Although the biggest changes and challenges are in the field of internet-based services, traders of goods cannot disregard the VAT and customs implications of their supplies. When businesses are striving to provide excellent service in effort to retain their customers, they often forget the additional obligations this may trigger.

Depending on the agreed delivery terms, additional VAT registration obligations may arise in the countries of destination. Such businesses should also carefully consider the location(s) of their warehouse(s), which may prove helpful in rationalising their supply chains and VAT as well as import and export compliance obligations.

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Within the EU, internet-based retailers can apply the "distance-selling" rules when selling goods to B2C customers in other EU countries. These rules allow businesses that do not exceed a certain turnover from such intra-EU sales not to register for VAT in the country of their B2C customers. Rather, retailers can charge the local VAT rate of the country in which they are based. This simplification can be applied until the distance-selling threshold in the country of destination (EUR35,000 or EUR100,000 or the equivalent in national currency) is breached. The amount must be monitored on a country-by-country basis and if surpassed, the retailer is required to register for and charge local VAT.

In the event of export sales (i.e. from the EU to non-EU customers or between non-EU countries) businesses must bear in mind that in general VAT is not applicable in relation to the export of goods. However, if the retailer also handles the import of goods in the customer's country of residence (for the convenience of the customer), additional VAT and customs compliance implications may arise.

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V. International outlook: Internet sales tax in the US is on the horizon

At the time this article was written, the Market Place Fairness Act of 2013, which aims to substantially reform the taxation of the e-commerce industry in the US, had just been passed by the US Senate. The new bill will result in increased tax revenues throughout the US. The legislation is meant to put online vendors on an equal standing with "brick and mortar" stores in terms of tax collection. Currently, most of the online vendors do not charge sales tax unless they have some sort of physical presence (i.e. "nexus") in the state they are selling to, while high-street stores have to charge local sales tax at their location.

According to the bill, US online vendors with over $1 million in annual online revenue will be required to pay state and local taxes to the governments of the states in which their customers reside. The bill will also impose additional compliance requirements on online vendors, which could (and, depending upon their business model, most probably will) end up with their having to account for sales tax in a large number of tax jurisdictions at a wide array of different tax rates – as opposed to physical stores, which in principle charge sales tax only at their own location(s). Considering that there are nearly 10,000 different state and local tax jurisdictions within the US, some commentators warn that this might end up being too big a burden for a lot of small and medium-sized online businesses that could face difficulties in fulfilling all the various compliance and other administrative obligations.

VI. Conclusion

Our article is limited to only certain aspects of this topic. In addition to the described EU and US developments, other countries are also observing and responding to this trend towards online taxation. Malaysia has recently introduced withholding tax on e-services; South Africa and Japan announced that some sort of online taxation may be implemented as early as 2014. Some other countries are also considering similar steps in the near future.

One should be aware that governments around the world are keen to keep up with the technological developments and find ways to impose taxes on internet-based trade. Businesses and tax advisors around the world should therefore keep monitoring these taxation trends and make sure that they are ready and able to adapt to the tax challenges of the digital transformation.

Tom Borec is a Senior Manager in the VAT department of PwC in Zurich/Switzerland and founder of PwC's ebiz and ecommerce blog: ebiz.pwc.com. He may be contacted by email at: c.borec@ch.pwc.com

Michaela Merz is a Partner in the VAT department of PwC in Zurich/Switzerland. She may be contacted by email at: michaela.merz@ch.pwc.com

Andras Salanki is an Assistant Manager in the VAT department of PwC in Zurich/Switzerland. He may be contacted by email at: andras.salanki@ch.pwc.com

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[1] Proposal for Council Regulation amending Implementing Regulation (EU) No 282/2011 as regards the place of supply of services (COM(2012) 763 final).