



University of
LODZ



Faculty of Law
and Administration

Małgorzata Sęk

***Reverse charge
as a mechanism of taxation of intra-EU services***

Summary

A Ph.D. dissertation prepared
in the Substantive Tax Law Department
under the supervision of Prof. Dr. Włodzimierz Nykiel

Lodz 2016

The value added tax (VAT) applicable in the European Union (EU) is territorial. Thus, taxable in a given Member State are only these supplies of goods and services, the place of supply of which is located in this Member State, regardless whether the supply is made by a taxable person affiliated to this Member State or by a foreign taxable person. The place of supply rules are harmonized to a large extent.

The place of taxable transactions, also referred to as the place of supply, is a conventional category. It must be distinguished from the actual place of performance, which is a factual category. Depending on the decision taken by the lawmaker, the place of supply might match the actual place of performance or not.

Due to the progressive globalization and dematerialization of the economy, development of transport and telecommunications and information technologies, as well as territorial links favored by lawmakers, supplies of goods and services can, and in practice indeed are, more and more often taxable in the country where the supplier of goods or services is not present, permanently, or even temporarily, i.e. does not have a business establishment, a fixed establishment, a permanent address or a habitual residence, does not have a real estate, any goods or equipment and does not perform actual activities making up the supply of services.

If the supply of goods or services is performed by a foreign supplier, i.e. a supplier that does not have in a given country his business establishment and any other fixed establishment connected with his business activity, liable to pay VAT (liable to account for VAT) is either the supplier, who is then obliged to register in the country of taxation, or the customer connected with the country of taxation. In the latter situation reverse charge mechanism applies, as a special collection mechanism. This mechanism is referred to as “reverse” charge, because the liability to pay VAT (the liability to account for VAT) lies with the customer, while normally it lies with the supplier (see Art. 193 of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (hereinafter: VAT Directive)¹). Thus, the usual rules for the payment (accounting for) tax are reversed.

The function of reverse charge as a method of collection of VAT on cross-border transactions is twofold. Firstly, it is a simplifying mechanism – eliminating the need for registration and tax filing in a country foreign for the supplier. Secondly, by applying the reverse charge, the country of taxation imposes the obligation to pay (account for) the tax on the customer that is under its enforcement jurisdiction, i.e. a customer that is at least registered for VAT in the country of taxation or, optimally, has his business establishment, fixed establishment, or permanent address or habitual residence in the country of taxation. It increases the chances for successful tax collection as compared to the situation when the payment is required from a foreign supplier. Since the collection of consumption taxes from consumers is generally inefficient and ineffective: burdened with high costs and high risk of lack of voluntary payment, which caused that indirect taxes have

¹ OJ L 347, 11.12.2006, p. 1, as amended.

been widely adopted for taxing consumption, reverse charge applies only to B2B transactions (*Business to Business*, or – under the UE common system of VAT – a taxable person to a taxable person transactions), and not to B2C transactions (*Business to Consumer*, or - under the EU common system VAT – a taxable person to a non-taxable person transactions).

In the EU common system of VAT analyzed as a whole, reverse charge is an exception, while in the case of cross-border B2B services, it constitutes the rule. According to Art. 193 VAT Directive “VAT shall be payable by any taxable person carrying out a taxable supply of goods or services, except where it is payable by another person in the cases referred to in Articles 194 to 199b and Article 202.” It follows from Art. 194 VAT Directive that where the taxable supply of services is carried out by a taxable person who is not established in the Member State in which the VAT is due (i.e. a taxable person who does not have there its business establishment and any fixed establishment intervening in the supply²), Member States may provide that the person liable for payment of VAT is the person to whom the services are supplied. In such cases the use of the reverse charge mechanism is left at the discretion of the Member States - is an optional solution, permitted, and not imposed by the VAT Directive. Based on Art. 196 VAT Directive, reverse charge is, however, mandatory in the case of B2B services provided by non-established suppliers and covered by the general rule for determining the place of supply, regulated by Art. 44 VAT Directive. According to the latter provision, the place of supply of B2B services is the customer’s Member State – the place where the customer has established his business. However, if those services are provided to a fixed establishment of the taxable person located in a place other than the place where he has established his business, the place of supply of those services is the place where that fixed establishment is located. In the absence of such place of establishment or fixed establishment, the place of supply of services is the place where the taxable person who receives such services has his permanent address or usually resides. Particular provisions on the place of supply are applicable to the following B2B services: services connected with immovable property, restaurant and catering services, short-term hiring of a means of transport, passenger transport services, admission to cultural, artistic, sporting, scientific, educational, entertainment or similar events, such as fairs and exhibitions, and ancillary services related to the admission, services of travel agents taxed under a special margin scheme. In the case of services falling under the special provisions, reverse charge is an option and Member States, according to Art. 194(2) VAT Directive, may lay down the conditions for the application of reverse charge.

Reverse charge mechanism applied in the EU to cross-border services has not been comprehensively analyzed in the Polish and English literature. It is surprising, given that, as already indicated, the reverse charge is currently the main rule of cross-border B2B services, and the catalogue of services not covered by it is narrow and, because of the option provided for in Art. 194 VAT Directive, varied across the EU. Reverse charge as a mechanism complementary to the

² See Art. 192a VAT Directive.

place of supply rules directly implementing the destination principle, strongly affects the functioning of the internal market, which is after all one of the fundamental objectives of the Union, and the realization of which is the aim of the harmonization of VAT. According to the fourth recital of the preamble to the VAT Directive, “The attainment of the objective of establishing an internal market presupposes the application in Member States of legislation on turnover taxes that does not distort conditions of competition or hinder the free movement of goods and services. It is therefore necessary to achieve such harmonization of legislation on turnover taxes by means of a system of value added tax (VAT), such as will eliminate, as far as possible, factors which may distort conditions of competition”. The common place of supply rules, as well as the reverse charge as a supplementing mechanism, belong to the measures designed to eliminate factors distorting the freedom of movement and the conditions of competition: the phenomenon of double taxation, the phenomenon of double non-taxation, the impact of differences in the level of tax burden in individual countries on location decisions of businesses and purchasing decisions of businesses and consumers and the increased level of administrative burden and risk associated with undertaking cross-border activities in the Union compared with the activities in the domestic market.

The aim of this study is to examine, whether reverse charge, in such form, as has been regulated under EU law and implemented in the Member States, as a mandatory and an optional mechanism applied to cross-border services within the EU, is conducive to the attainment of the internal market and meets other requirements for the institutions of the EU common system of VAT. The other requirements have been determined based on: the principles of the EU common system of VAT, the postulates of the most recent programme documents on the future of the EU VAT system, i.e. the *Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the future of VAT. Towards a simpler, more robust and efficient VAT system tailored to the single market* (hereinafter: Communication 2011/851)³ and the *Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on an action plan on VAT Towards a single EU VAT area - Time to decide* (hereinafter: Communication 2016/148)⁴, *International VAT/GST Guidelines* (hereinafter: *OECD Guidelines, VAT Guidelines* or *Guidelines*)⁵ drafted by the Organization for Economic Cooperation and Development (OECD), in particular its

³ COM(2011)851 final, Brussels, 6 December 2011.

⁴ COM(2016)148 final, Brussels, 7 April 2016.

⁵ OECD, *International VAT/GST Guidelines*, Paris, 6 November 2015. This document was approved by the OECD Committee on Fiscal Affairs (CFA) on 7 July 2015 and endorsed by the representatives of 104 jurisdictions during the annual meeting of the OECD Global Forum on VAT on 5-6 November, in Paris, France. In 2016 an OECD Recommendation will be issued embodying the complete set of Guidelines and open to adherence by all interested non-OECD Members.

part concerning “generally accepted principles of tax policy applicable to consumption taxes”⁶, as well as the contemporary tax principles derived from the tax thought of A. Smith⁷.

The study analyzes the application of reverse charge to services, leaving outside the scope of considerations supplies of goods. As has already been mentioned, reverse charge mechanism is applied to B2B services, thus B2C services have been omitted. The object of the research is the application of reverse charge in taxation of intra-EU services, understood as services, whose place of supply is located in other EU Member State than the Member State of the supplier. This “other Member State” shall mean the Member State in which the supplier of the services does not have his business establishment or a fixed establishment intervening in the supply⁸, and in the case of suppliers who in general do not have a business establishment and a fixed establishment - the Member State where the supplier of the service does not have a permanent address or a habitual residence. Hence, the term “intra-EU services” is used in the dissertation not only to refer to services covered by the general place of supply rule and mandatory reverse charge and declared in recapitulative statements⁹, which are referred to as “intra-Community supplies of services”¹⁰. Although they are sometimes called “intra-Community services”, there is no basis in EU law for that. The terms “intra-Community services” and “intra-EU services” are not mentioned in the VAT Directive, the Council Implementing Regulation (EU) No 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax (hereinafter: VAT Regulation)¹¹ or any other EU legal act, thus they are not legal terms.

It is worth emphasizing that reverse charge as applied to cross-border services within the EU cannot be analyzed without reference to place of supply rules, not only because it constitutes a complementing, accompanying mechanism to the place of supply rules, but also because, the scope of application of the general place of supply rule for B2B services directly determines the scope of application of the mandatory reverse charge mechanism. Reverse charge and place of supply rules belong to a broader category of cross-border issues in the taxation of services, which will be dealt with in the dissertation.

The dissertation consists of an introduction, four chapters and a conclusion. Its structure is subordinated to the purpose of the study, the implementation of which also requires answering the following specific questions:

- what requirements should the institutions of the common EU VAT system meet, including in particular the reverse charge mechanism?

⁶ *OECD Guidelines*, point 1.16.

⁷ A. Smith, *The Wealth of Nations*, 5th ed., Methuen & Co. Ltd., London 1904, book V, chapter II, paras. 24-29, <http://www.econlib.org/library/Smith/smWNCover.html> [22.01.2012]; 1st. ed.1776.

⁸ See Art. 192a VAT Directive.

⁹ See Art. 262(c) and Art. 264(1)(a) VAT Directive..

¹⁰ See Art. 2(1)(h) of the Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax (recast), OJ L 268, 12.10.2010, p.1, as amended.

¹¹ OJ L 77, 23.3.2011, p. 1, as amended.

- what is the role of the reverse charge mechanism in the taxation of cross-border services, in particular intra-EU services and how this mechanism should be designed to meet its requirements?
- what is the scope of application of the reverse charge mechanism in case of intra-EU services and how advanced its harmonization is?
- what are the responsibilities and risks burdening the supplier of services and the customer in the case of application of the reverse charge mechanism to intra-EU services and what role do these entities play in the EU VAT system and the tax systems of the Member States?

The first chapter defines the requirements to be met by institutions of the common EU VAT system, and especially the reverse charge mechanism applied to intra-EU services. As already indicated, these requirements have been determined by reference to the principles of the internal market, the creation and smooth operation of which is the premise of VAT harmonization, as well as the basic principles of the common EU VAT system, which are supposed to reflect the legal and economic nature of VAT. The catalogue of requirements has been complemented on the basis of the guidelines for the “better” system of VAT formulated by the European Commission and the *OECD Guidelines*, as well as tax principles derived from A. Smith.

The second chapter presents the basic issues of taxation of cross-border services in the common EU VAT system. This is a necessary background for clarifying the role of the reverse charge mechanism in the taxation of cross-border services, especially intra-EU services. The second chapter explains the evolution of the place of supply of services rules in the common EU VAT system, the ultimate and the transitional model of the common EU VAT system, including the new, improved model presently being designed by the European Commission, and analyzes the role of the reverse charge in these models. It also discusses which irregularities and tax evasion opportunities, reverse charge eliminates and which are even enhanced by the mechanism. Against this background, it is stated how the reverse charge mechanism should be designed to best meet its requirements.

The third chapter examines in detail the scope of application of the reverse charge mechanism in the taxation of intra-EU services - in the light of the current EU and Member States’ legislation, by making a distinction between the reverse charge applied due to the foreign status of the supplier of the service or the particular vulnerability of transactions to fraud and the reverse charge applied as a mandatory or an optional mechanism. This analysis is necessary to determine whether the scope of application of the reverse charge mechanism has been set correctly and how advanced its harmonization within the EU is.

The last chapter is devoted to examining the legal position of the supplier of the service and the customer in the case of intra-EU services covered by the reverse charge mechanism. Their duties, rights and liability have been analyzed, with particular emphasis on the risk of incurring tax

liability in connection with fraud committed by the counterparty or other irregularity in the tax settlements of the counterparty. The fourth chapter also presents the issue of exchange of information on intra-EU services between Member States, as an issue directly related to the registration and information duties of transaction parties.

The analysis has been the basis for identifying the most important disadvantages and advantages of the current regulation of the reverse charge mechanism in the light of the adopted criterion i.e. the compliance with the requirements set for the reverse charge as an institution of the common EU VAT system. On this basis, *de lege ferenda* proposals addressed to the EU legislator have been developed.

In order to achieve the research goals the following have been analyzed: legal acts of the European Union and its Member States, case law of the Court of Justice of the European Union (hereinafter: the Court, CJEU), opinions of Advocates General, guidelines of the VAT Committee, as well as other documents of EU institutions (the European Commission, the Council of the European Union, the European Parliament) and their advisory bodies, including in particular communications, reports, positions, and studies prepared on their behalf. In addition documents drawn up by the OECD have been included. Also scholarly literature has been analyzed.

Maigomay Sh