European Union:

How the EU's Value-Added Tax (VAT) Impacts U.S. Exports - January 2019

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Summary

This report provides an overview of the EU's Value Added Tax (VAT) rules and how these rules impact U.S. exporters of goods and services to the EU. VAT is a consumption tax that is charged on most goods and services sold in the EU. The lists of VAT exemptions are defined by the individual EU Member States and thus vary from country to country. While the guidelines for VAT policy are set at EU level, the Member States implement, administer and enforce the rules. Therefore, while the EU sets minimum rates, Member States define their own VAT rates, which currently vary between 17%-27%. Member States, at their discretion, may apply reduced rates for specific goods and services, or even temporary derogations. This report focuses on the basic set of principles that will help U.S. companies understand and navigate the VAT system.

Introduction

VAT is a consumption tax that applies to most goods and services and is paid by the final consumer. A reduced rate of VAT can be applied to a restricted list of goods and services referred to in Annex III of the EU VAT Directive 2006/112/EC.

The tax is collected from final consumers by "*taxable persons*" who will then in turn pay the collected amount to the revenue authorities of the Member State where the transaction has taken place (place of supply). A "taxable person" is described as any individual, partnership, or *company that supplies taxable goods and services in the course of business*. Thus "taxable persons," where stated in this report, refers to these categories of individuals/entities that are involved in economic activity.

Taxable persons can deduct the amount of VAT they have incurred during purchases made from their overall VAT obligations due to specific Member State revenue authorities. VAT obligations for U.S. companies involving business transactions can vary according to the following criteria:

- From where the U.S. company is operating;
- Where a company's final customers are based;
- Types of good and services sold;
- Whether a particular customer is a business or a consumer; and
- Whether services or goods are being supplied by the original company.

The most important pieces of legislation on VAT are the EU VAT Directive 2006/112/EC and its Implementing Regulation 282/2011.

Topics in this report:

- Section I: Overview of the VAT system and how it works;
- Section II: How VAT impacts U.S. companies supplying goods to the EU or within its borders;
- Section III: Rules for providing services to EU customers;
- Section IV: Specific VAT rules applicable when supplying ESS (Electronically Supplied Services);
- Section V: Business activities that may qualify for a VAT refund;
- Section VI: Useful web links.

I. What is the VAT? How does VAT work? And who pays for VAT?

The VAT is a tax on consumer spending that is collected by VAT registered traders on sales of goods and services. The premise behind the VAT is that a tax on the "value added" is imposed at each stage of production and sales process of a good; it is the final consumer – at the end of this process – who absorbs the tax as part of the total purchase price. "VAT is charged when VAT-registered (taxable) businesses sell to other businesses (B2B) or to the final consumer (B2C). VAT is intended to be 'neutral' in that businesses are able to reclaim any VAT that they pay on goods or services. Ultimately, the final consumer should be the only one who is actually taxed. Businesses operating in the EU are given a VAT identification number and have to show the VAT charged to customers on the invoices."[1]

Please note: Not all goods and services are subject to VAT. For a list of VAT exemptions, consult Title IX and for the list of goods and services with reduced VAT rates please see Annex III of the VAT Directive.

a) Taxing Process

Companies need to pay out VAT on business inputs before being able to recover it through their VAT returns. VAT is charged when a VAT registered business sells to either another business (a "taxable person") or non-business customer (a "non-taxable person"). There are two forms of VAT relevant to business transactions: *Output* and *Input* VAT. Each participant in the supply chain – from manufacturer to retailer, through wholesaler and distributor – charges VAT on the sales it makes. This is labeled *Output VAT*. When a trader pays VAT on its purchases, this is referred to as *Input VAT*. Traders take what VAT they have received and compare it to the VAT they have paid out themselves and then submit the surplus to the appropriate VAT authority. If their total VAT payments (input VAT) surpass their total VAT receipts (output VAT), then the entity receives the difference.

When a VAT registered business buys goods or services, it can generally reclaim the VAT it has paid. Please note that if an entity is not a VAT registered business, it may not reclaim VAT that it has paid on goods and services. One must establish a business as a "VAT-registered business" if it sells VAT-taxable goods and/or services and turnover for a 12-month period reaches or exceeds a certain financial threshold. To check with a particular tax authority in a Member State country where one wishes to do business, consult the list here. (See the VAT refund section below).

[1] "Questions and Answers: Value Added Tax," European Commission Memo 11/874, 6 December 2011.

b) VAT Rates

The EU's VAT system is semi-harmonized. While the guidelines are set out at EU level, the implementation of VAT policy is the prerogative of Member States. The EU VAT Directive allows Member States to apply a minimum standard VAT rate of 17%. However, they may apply reduced rates for specific goods and services or temporary derogations. Therefore, the examination of VAT rates by Member States is strongly recommended. These and other rules are laid out in the VAT Directive.

The best sources for navigating the VAT process are the following websites of the European Commission:

- Basic information on the application of VAT in the Member States
- An updated list of the Member States' VAT rates
- Table of the derogations
- A List of the Member States' VAT authorities

For more information on VAT rules, see the EU's VAT webpage, its webpage on the place of taxation, and the EU's VAT Committee guidelines. Please keep in mind that the VAT Committee guidelines are not legally binding and can therefore be challenged by Member States.

II. How does VAT impact a U.S. company's supply of goods and what is its VAT obligation?

VAT is applied at the *place of supply* of a good or service (meaning where the good is sold or provided to the end user). Therefore, VAT is relevant when the *place of supply* is in the EU, as this determines the VAT rate to be applied to the transaction. Regarding cross-border sales between a business and another business (between EU states), the VAT is calculated and collected in the Member State where the final sale of the good (or *service*, discussed below) takes place. The VAT for goods (and services) provided by a business to a *customer* is paid by a supplier in the Member State where the sale occurs or where the supplier is established.

It is important to note, however, that the "place of supply" principle *does not always* determine whether it is the supplier or the customer who is liable to pay the VAT to the tax authorities. A supplier's VAT registration and collection responsibilities depend on several variables, the most important of which are:

- Where the supplier is based;
- Where the customers of the supplier are based;
- Whether the supplier's customer is a private consumer or a business; and
- Whether services or goods are being supplied by the company

The following sub-sections present VAT scenarios that a typical U.S. exporter and business might face.

a) The shipment of goods from the U.S. to the EU

U.S. goods imported into the EU will be taxed at their point of entry into the Member State where they are cleared. There is no central EU VAT rate; therefore, the taxation rate is subject to the Member State where the goods enter. (See above: VAT rates)

However, there is an exception to this rule. If the goods are placed under a "suspensive customs procedure" (which is considered an "in-transit" procedure) when they enter the European Union, the VAT rate on the imports will be representative of the Member State where the goods finally rest.

The VAT rate on imports is calculated based on the value of the goods plus any customs duty. The person or firm responsible for paying this VAT rate is called the *importer of record*. If the U.S.-based exporter is listed as the *importer of record,* then the U.S.-company takes on all responsibilities associated with the VAT. However, in most "**business to business**" transactions (B2B), the *importer of record* is the business customer located within the European Union.

This means that, in general, the U.S.-based supplier does not need to register for VAT or collect tax on the sale. However, for some Member States, the U.S.-based company is indeed required to register for VAT, regardless of their role in the transaction (e.g. the United Kingdom established such an obligation since December 2012). To determine whether the Member State you wish to do business in requires U.S. companies to register for VAT, please consult the respective Member State's VAT or taxation websites here.

b) VAT on the cross-border supply of U.S. goods within the EU (Intra-EU movement)

As just discussed, an import tax must almost always be paid when a U.S.-produced good arrives in the EU. Once a product has been imported into one particular Member State, VAT is subsequently applied to its onward supply to customers in other Member States. Determining the place of taxation depends, according to the VAT legislation, on where the *acquisition* of goods legally takes place, usually the final destination.

For goods traveling to customers in other countries (beyond the import country), the supplier of the goods does not have to pay VAT on the transaction *if* the end business customer has a registered VAT number that is then attached to the invoice. The customer applies the local VAT rate using the *reverse charge* procedure, meaning that the business customer here, for VAT purposes, acts as both the supplier and the recipient. This intra-EU transaction is called an *acquisition*.

If a U.S. business/producer is selling goods within the EU directly to consumers who do not apply VAT to their acquisition (meaning they do not have a VAT number) the *rule of distance selling threshold* is applied. This means that for instance, a U.S. company operating its EU base out of Ireland can charge Irish VAT on its sales of products to consumers in other Member States if the total value of sales to one of those Member States remains below *the distance selling threshold*. *Thresholds* vary for each Member State. U.S. companies need to register for VAT in each Member State where the threshold is breached. The *threshold* only applies to goods sent from a VAT registered business in one EU Member State to a non-VAT registered consumer in another.

U.S. companies can arrange for an EU-based agent, registered for VAT purposes, to import and supply goods on their behalf. The agent will be considered the *principal* for VAT purposes. The *principal* would make any necessary customs entries as the importer, pay or defer the VAT, and take delivery of the goods.

When a U.S. exporter uses a *principal* (also known as an *importer of record*) to handle the import procedures, this import agent would normally then complete the import declarations. The importer of record will need to acquire an Economic Operator Registration and Identification (EORI) Number. The "Importer of Record" pays the customs authorities the appropriate import VAT. Because the goods imported are not for the purpose of the *agent's* business, they cannot reclaim what they paid in VAT as an input tax. Thus, they would normally charge the already paid import VAT amount to the U.S.-based exporter. U.S. companies often pay this VAT as part of the total fee to the shipper/forwarder in the EU. However, if the U.S. company registers itself as the *importer of record* and is therefore "registered" for VAT, then it can reclaim this import VAT.

III. VAT rules on the supply of services to EU customers

The EU's VAT law considers everything that is not a good (generally a tangible property) as a service. Services can include everything from the licensing for intellectual property to downloadable software to consulting – to name but a few examples. The VAT requirements for services depend on the final customer:

- For a taxable service (a Business-to-Business relationship), the supply of service is taxed where the customer is established;
- For a non-taxable service (a Business-to-private individual customer relationship), the supply of service is taxed where the supplier of the service is established.

There are also a number of exceptions to the above described two-way taxation rule, which include – among – others:

- B2C services provided by an intermediary are taxed at the location of the main transaction;
- B2B and B2C services connected with immovable property are taxed at the location of the property.

When it comes to B2B transactions, in many cases, the business customer will account for VAT using the *reverse charge procedure* thus making it not necessary for a U.S. based supplier to register for a VAT number in the EU. However, under certain circumstances - depending on the relevant legislation of each Member State -, *registration* for VAT purposes is necessary. This may occur when the buyer is a non-business customer not registered for VAT purposes.

IV. Specific VAT rules on Electronically Supplied Services (ESS) to EU non-business customers (Article 58 of VAT Directive)

From 1 January 2015, all supplies of telecommunications, broadcasting and electronic services will be taxable at the place where the customer is located. In the case of businesses, this means either the country where it is registered or the country where it has fixed premises receiving the service. In the case of consumers, it is where they are registered, have their permanent address, or usually live.

a) What is an electronically supplied service?

Electronically supplied services (ESS) are defined in Article 7 of Implementing Regulation (EU) No 282/2011 as services which are delivered over the Internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention, and impossible to ensure in the absence of information technology. Moreover, Annex II of the VAT Directive gives an illustrative, but non-exhaustive, list of the types of supplies that can be considered ESS. The European Commission's VAT Committee has issued non-binding guidelines on what can be considered ESS. Their guidelines suggest a two-step test to assess whether a given supply can be considered an ESS: "An ESS should be reliant on the Internet or similar network for its provision" and "be essentially automated, involving minimal human intervention." Therefore, where an electronic network such as the Internet is used simply as a means of communication in much the same manner as a telephone or fax machine, the service provided might not be considered an ESS because the service relies on substantial human intervention.

In addition, the European Commission has issued explanatory notes to provide a better understanding of the implementation mechanism. Again, please keep in mind that these notes are **not** legally binding and can therefore be challenged by Member States.

b) Taxation obligations of ESS

Article 58 of the VAT Directive places VAT requirements on U.S.-based suppliers of ESS to non-business customers (non-taxable persons). The provision states that any ESS provided by a non-EU country to non-taxable persons in an EU country must be taxed at the place where the customer has a permanent address or currently is residing at the time of the provided service. Sales made to business customers require the importing company to pay the VAT under the *reverse charge procedure*. Consequently, all VAT-registered U.S. companies would file VAT receipts to EU-based VAT authorities following transactions of ESS good and services with non-taxable EU persons.

In order to comply with the legislation, companies need to identify whether their consumers are business or non-business customers and where they are located, since VAT rates differ among Member States. The EU's VAT Information Exchange System (VIES), listing VAT-registered companies, can help find such information. Concerning the location of the customer, the VAT rate is calculated on the basis of a customer's declaration, potentially verifiable against a credit card billing address or by geo-locating tools. For more information on the functioning of the VIES, please click here.

c) One Stop Shop (MOSS)

The Commission launched the (Mini) One Stop Shop ((M)OSS) scheme in 2015. It is intended to facilitate the sales of ESS from taxable to non-taxable persons (B2C) located in Member States in which the sellers do not have an establishment to account for VAT. The scope was expanded in 2017 to include online sales of goods and services by EU suppliers or platforms, to enter into force in 2021.

This optional scheme allows taxable persons (sellers) to avoid registering in each Member State of consumption. A taxable person who is registered for the One Stop Shop in a Member State (the Member State of Identification) electronically submits quarterly One Stop Shop VAT returns detailing supplies of ESS to non-taxable persons in other Member States (the Member State(s) of consumption), along with the VAT due. These returns, along with the VAT paid, are then transmitted by the Member State of Identification to the corresponding Member States of consumption via a secure communications network. Therefore, by using MOSS, companies selling ESS to non-taxable persons located in various Member States can avoid collection and payment of VAT to multiple Member States authorities. Once a company registers for the MOSS service it needs to use it in all transactions and cannot opt-out of it on an individual basis.

With the changes introduced in 2017, One Stop Shop was also extended to suppliers outside of the EU. In practice, it means that a business not established in the EU but having a VAT registration in the EU can make use of the One Stop Shop (OSS) scheme. They no longer have to register in multiple countries for tax purposes. The threshold for such transactions has been amended too: where the total value remains below a threshold of € 10,000 annually, the suppliers of digital services will continue to be subject to the VAT rules of the country of VAT registration.

d) Options for U.S. Exporters on dealing with ESS

Companies impacted by VAT rules have several options to achieve compliance. This report does not make any endorsements or recommendations, but presents the following options for U.S. businesses:

- **Register for VAT in one of the 27 EU Member States** and apply the rate of VAT applicable in that Member State to all their ESS sales to customers within the EU.
- **Register for VAT in each Member State where they make sales to non-business customers** and collect VAT at the rate applicable in those Member States, therefore making separate returns to each national VAT authority.
- **Sell ESS through local EU-based distributors** by redirecting potential customers to their websites. The distributor would apply the local rate of VAT applicable in its country and handle VAT administration with the local authorities.
- **Outsource electronic transactions to an E-commerce Service Provider** including VAT collection and administration, among other services.

V. VAT Refunds

A taxable person (meaning a business conducting economic activity in the supply of goods or services) has various options but should be mindful that there are VAT refund exemptions.

(1) It can deduct VAT that was made on purchases if the goods and services are used for economic activity. If not, then such a business cannot apply for a VAT deduction.

(2) As mentioned in the beginning of this report there is also an opportunity to receive a VAT refund if a taxable person's *input VAT* exceeds its *output VAT*. The refund is the excess that was paid. However, checking this policy on a country by country basis is recommended because some Member States allow the excess VAT paid to be carried over into the next taxable period to offset any proceeding taxation that may be due by a company.

(3) U.S.-based companies with no subsidiary in the EU must pay VAT related to their business dealings in a Member State *where they do not supply goods or services* but have a right to a refund in the Member State where the VAT was incurred.

Links to the VAT refund procedures in the Member States are on the EC website on VAT refunds.

VI. Additional Links

UK's HM Revenue and Customs VAT website
Digital Services (UK Govt website)

For More Information
For more information on this topic, or for a copy of our related reports, please contact: office.brusselsEC@trade.gov. The U.S. Commercial Service at the U.S. Mission to the European Union is located at Boulevard du Regent 27, Brussels BE-1000, Belgium.
The U.S. Commercial Service can be contacted via e-mail at: office.brusselsEC@trade.gov or by visiting the website: http://export.gov/europeanunion

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