

**USE AND ENJOYMENT OF INTANGIBLE SERVICES:
THE GERMAN, AUSTRIAN, DANISH AND ESTONIAN VAT
DEROGATIONS**

Boston University School of Law Working Paper No. 09-11
(March 5, 2009)

Richard T. Ainsworth

This paper can be downloaded without charge at:

<http://www.bu.edu/law/faculty/scholarship/workingpapers/2009.html>

USE AND ENJOYMENT OF INTANGIBLE SERVICES: THE GERMAN, AUSTRIAN, DANISH AND ESTONIAN VAT DEROGATIONS

Richard T. Ainsworth

When the Czech Republic elected¹ (effective January 1, 2009) to derogate from the standard rules for determining the place of supply for intangible services, pursuant to Article 58 of the Recast VAT Directive (RVD),² it was following the lead of at least ten other Member States.³ This paper considers four of those other jurisdictions – Germany, Austria, Denmark and Estonia – and compares their derogations with that of the Czech Republic.⁴

The affected transactions are (potentially) wide ranging.⁵ RVD 58 only allows the use and enjoyment standard when non-EU countries are on one end of the impacted transaction. As a result, these rules can easily become a trap for unwary businesses (particularly non-EU businesses). Traditional proxy-based rules (RVD Articles 43 and 56(1)) are being selectively and inconsistently overturned for this market segment.

Each Member State that has taken up this derogation has felt the need to limit its impact. For example, the new Czech rules⁶ uniquely turn on the presence of a permanent establishment (PE) in the Czech Republic. These rules function like a full force of attraction principle in direct taxation.⁷ None of the other Member States anticipated the Czech approach, and it is an attribute

¹ Czech Value Added Tax Act of 235/2004, at Art. 10, para. 14. (Czech VAT legislation can be found at: *Zákon č. 235/2004 Sb. o dani z přidané hodnoty ve znění pozdějších předpisů*).

² On November 28, 2006, Directive 2006/112/EC on the common system of value added taxation (recasting the First and Sixth VAT Directives) was adopted, entering into force on January 1, 2007. The RVD replace the SIXTH DIRECTIVE (Directive 77/388/EEC of 17 May 1977).

³ Jurisdictions adopting a use and enjoyment standard for determining the place of supply for intangible services also include: Belgium, France, Italy, the Netherlands, and Slovenia.

⁴ For a detailed consideration of the new Czech rules see: Richard T. Ainsworth, *Use and Enjoyment of Intangible Services: the Czech Republic's VAT Derogation*, TAX NOTES INT'L (forthcoming, Mar. 16, 2009).

⁵ RVD Art. 56 (1) lists the following services:

- (a) Transfers and assignments of copyrights, patents, licenses, trademarks and similar rights;
- (b) Advertising services
- (c) The services of consultants, engineers, consultancy bureaus, lawyers, accountants and other similar services, as well as data processing and the provision of information;
- (d) Obligations to refrain from pursuing or exercising, in whole or in part, a business activity or a right referred to in this paragraph;
- (e) Banking, financial and insurance transactions, including reinsurance, with the exception of the hire of safes;
- (f) The supply of staff;
- (g) The hire out of movable tangible property, with the exception of all means of transport;
- (h) The provision of access to, an the transportation or transmission through, natural gas and electrical distribution systems and the provision of other services directly linked thereto;
- (i) Telecommunication services;
- (j) Radio and television broadcasting services;
- (k) Electronically supplied services, such as those referred to in Annex II.

⁶ See Pavel Fekar & Daniela Vykyšala, *Czech President Signs Amendment to VAT Act*, Tax Analysts WTD 177-8; Doc 2008-19099 (Sept. 11, 2008).

⁷ KLAUS VOGEL, KLAUS VOGEL ON DOUBLE TAX CONVENTIONS 3rd ed. (1997) 402 at ¶10, 421 at ¶ 48-49. (discussing the various permutation of the force of attraction principle – a “full” force of attraction that attracts all

of the law in this area that no two Member States derogate in precisely the same manner. Unfortunately, this causes confusion, and it is a confusion that is not likely to go away when the new place of supply rules for services become effective, January 1, 2010.⁸

BACKGROUND

Even though the intent has always been to tax services at the place of final consumption, this has proven difficult to accomplish.⁹ As a result, under the EU VAT services are sourced by proxy. Two sets of proxy rules provide the background to the use and enjoyment rules this paper considers – these are the main proxy rule, and the proxy-exceptions.

RVD 43 sets out the main rule for all services; RVD 56(1) contains exceptions for intangible services – there are additional exceptions applicable to other services.¹⁰ The main (and therefore fall-back) rule deems all services to be supplied at the *seller's location*. RVD 43 states:

The place of supply of services 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, or, in the absence of such a place of business or fixed establishment, the place where he has his permanent address or usually resides.¹¹

income sourced to a jurisdiction; a “restricted” force of attraction that attracts only income of the same type or kind as the income earned by the PE; “no” force of attraction that subjects only income earned by the PE to tax).

⁸ COUNCIL DIRECTIVE 2008/8/EC amending Directive 2006/112/EC as regards the place of supply of services, Sec. 2, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:044:0011:0022:EN:PDF>.

⁹ See *Id.*, at (3)

For all supplies of services the place of taxation should, in principle, be the place where the actual consumption takes place. If the general rule for the place of supply of services were to be altered in this way, certain exceptions to this general rule would still be necessary for both administrative and policy reasons.

¹⁰ For example, RVD 44 has exceptions for services by intermediaries; RVD 45 has exceptions for services connected with immovable property; RVD 46-51 contain exceptions for the supply of transportation RVD 52-55 contain exceptions for supplies of cultural services, ancillary transport services and services related to movable tangible property.

¹¹ Directive 2006/112/EC has been prospectively amended with an effective date of January 1, 2010. This amendment changes the structure of this provision. Most noticeably the current article is split in two and each part is made a separate article. Under the amended provisions the articles will be RVD 44 and 45. The B2B rules are contained in Article 44. The proxy used is the buyer's location. The new article reads (emphasis added):

The place of supply of services to a *taxable person* acting as such shall be the place where that person 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 shall be 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 shall be the place where the taxable person who receives such services has his permanent address or usually resides.

The companion provision in new Article 45 deals with all non-business service transactions. The proxy used is the seller's location. The new article reads (emphasis added):

The place of supply of services to a *non-taxable person* shall be the place where the supplier has established his business. However, if those services are provided from a fixed establishment of the supplier located in a place other than the place where he has established his business, the place of supply of those services shall be 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 shall be the place where the supplier has his permanent address or usually resides.

RVD 56(1) isolates miscellaneous services (sometimes called intangible services) and provides a different proxy. Intangible services are deemed to be supplied at the *buyer's location*. But, things are not that simple.

RVD 56(1) does not change the proxy (from the seller's to the buyer's location) in every instance. Only two specific types of transactions in intangible services are impacted by RVD 56(1) – *first* are all the B2B transactions between two Member States,¹² and *second* are all transaction (B2B, B2E or B2C) where the seller is located within an EU Member State, and where the buyer is located outside the EU.¹³ (Missing is the *third* basic permutation – where non-EU businesses sell to EU customers – they are covered as a “fall-back” pattern under RVD 43). RVD 56(1) states:

The place of supply for the following services to customers established outside the Community, or to 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 for which the service is supplied, or, in the absence of such a place, the place where he has his permanent address or usually resides.¹⁴

Supra note 8.

¹² As a result B2C and B2E transactions involving intangible services between Member States are sourced under (or fall back to) the main rule in RVD 43 – where the place of supply for these transactions is at the seller's location. This is consistent with the results under the amended place of supply rules that are effective January 1, 2010 under new Article 45.

¹³ As a result B2B, B2E, and B2C transactions running in the opposite direction (from a seller's location outside the EU to a buyer located within the EU) are also sourced under (or fall back to) the main rule in RVD 43 – where the place of supply for these transactions is at the seller's location. The B2B part of this rule is changed under the under the amended place of supply rules that are effective January 1, 2010.

Under the new Article 44, all B2B transactions in services (whether they are going from EU to non-EU businesses or from non-EU businesses to EU businesses) are sourced at the buyer's location. A contrasting rule applies for B2E and B2C transactions. They are sourced at the seller's location under new Article 45.

¹⁴ There is a companion rule to RVD 56(1) in the amended place of supply rules that are effective January 1, 2010 – new Article 59. Although new Article 59 reads very much the same as RVD 59(1) there is an important change. New Article 59 is concerned with non-taxable persons (B2E and B2C) and intangible services, in instances where the recipient is located outside the EU. RVD 59(1) deals with all “customers” located outside the EU. In addition where RVD 59(1) set down rules for intra-community B2B transactions in intangible services, the amended place of supply rules do not take up this issue allowing these cases to be resolved by new main rule in Article 44. The proxy in all these cases [RVD 59(1); new Articles 44 and 59] is the same – the buyer's location. New Article 59 reads (emphasis added):

The place of supply of the following services to a *nontaxable person* who is established or has his permanent address or usually resides outside the Community, shall be the place where that person is established, has his permanent address or usually resides:

- (a) transfers and assignments of copyrights, patents, licenses, trademarks and similar rights;
- (b) advertising services;
- (c) the services of consultants, engineers, consultancy firms, lawyers, accountants and other similar services, as well as data processing and the provision of information;
- (d) obligations to refrain from pursuing or exercising, in whole or in part, a business activity or a right referred to in this Article;
- (e) banking, financial and insurance transactions including reinsurance, with the exception of the hire of safes;
- (f) the supply of staff;

To demonstrate the complexity of these rules consider a French business performing consulting services. If services are rendered to a French customer, French VAT will apply (domestic transaction); if they are rendered for an Italian *taxable person*, Italian VAT will apply (RVD 56(1)). However, if the same consultation services are provided to an Italian *consumer*, French (not Italian) VAT will apply (RVD 43 is used as a fall-back). If these services are rendered for a Swiss customer no EU VAT applies (RVD 56(1)), but a Swiss VAT may be applicable depending on the VAT rules in this (non-EU) jurisdiction.¹⁵

THE USE AND ENJOYMENT OPTION

Any Member State may, with respect to “any or all” of the services listed in RVD 56(1), move the place of supply within their territory (if the normal rule would put it outside the Community), or move the place of supply outside the Community (if the normal rule would put it inside their territory). The only requirement is that the movement of the place of supply must be determined by the location of use and enjoyment of the service. RVD 58 states:

In order to avoid double taxation, non-taxation or distortion of competition, Member States may, with regard to the supply of the services referred to in Article 56(1) and with regard to the hiring out of means of transport:

- a. consider the place of supply of any or all of those services, if situated within their territory, as being situated outside the Community, if the effective use and enjoyment of the services takes place outside the Community;
- b. consider the place of supply of any or all of those services, if situated outside the Community, as being situated within their territory, if the effective use and enjoyment of the services takes place within their territory.

However, this provision shall not apply to the services referred to in point (k) of Article 56(1), where those services are rendered to non-taxable persons.¹⁶

(g) the hiring out of movable tangible property, with the exception of all means of transport;

(h) the provision of access to, and of transport or transmission through, natural gas and electricity distribution systems and the provision of other services directly linked thereto;

(i) telecommunications services;

(j) radio and television broadcasting services;

(k) electronically supplied services, in particular those referred to in Annex II.

Where the supplier of a service and the customer communicate via electronic mail, that shall not of itself mean that the service supplied is an electronically supplied service.

¹⁵ At the present time there is no global standard on sourcing services and intangibles. In February 2006 the OECD Committee on Fiscal Affairs (CFA) launched a project aimed at providing guidance for governments on applying Value Added Taxes or Goods and Services Tax to cross-border trade. The goal is to produce a documenting that would offer guidance in this area, tentatively called the *International OECD VAT/GST Guidelines*. OECD, COMMITTEE ON FISCAL AFFAIRS, WORKING PARTY NO. 9 ON CONSUMPTION TAXES, APPLYING VAT/GST TO CROSS-BORDER TRADE IN SERVICES AND INTANGIBLES: EMERGING CONCEPTS FOR DEFINING PLACE OF TAXATION – OUTCOME OF THE FIRST CONSULTATION DOCUMENT (June 2008) available at: <http://www.oecd.org/dataoecd/11/31/40931170.pdf>

¹⁶ The companion provision to RVD 58 in the revisions effective January 1, 2010 is Article 59a which states:

In order to prevent double taxation, non-taxation or distortion of competition, Member States may, with regard to services the place of supply of which is governed by Articles 44, 45, 56 and 59:

It needs to be recognized that RVD 58 is written broadly, it is not limited to the transaction-types of RVD 56 (1) [intra-community B2B, and EU outbound transactions], and it does not simply *reverse the proxy* of RVD 56(1). RVD 58 is an unfettered, direct application of a *place of final consumption* standard. RVD 58 is not a *proxy*; it is the rule that the proxies were designed to approximate.

THE GERMAN ADOPTION OF USE AND ENJOYMENT RULES FOR INTANGIBLE SERVICES

The German VAT Law of 2005 (Umsatzsteuergesetz 2005) delegates to the Federal Ministry of Finance (Bundesministerium der Finanzen) the authority to issue a decree consistent with RVD 58 to avoid double taxation, or non-taxation, or to prevent distortion of competition.¹⁷ Excluding only services related to e-commerce and gas/ electric distribution systems, the grant of authority is broad and balanced.

The Federal Ministry of Finance has issued a conforming decree. It is selective and targeted at three situations: (a) the purchase of intangible services by German exempt entities, (b) the receipt of telecom, radio and television services by German customers, and (c) motor vehicle leasing activities by German and third country enterprises. The decree indicates:

Section 1. Special cases for the place of services.

- (1) If a company that runs its business from a place in a third country, renders
1. a service described in § 3a para. 4 no. 1 to 11 of the Law [a reference that includes all miscellaneous services, except for telecom services, radio and television services, e-commerce services and the provision of access to, and the transport and transmission through, natural gas and electricity

(a) consider the place of supply of any or all of those services, if situated within their territory, as being situated outside the Community if the effective use and enjoyment of the services takes place outside the Community;

(b) consider the place of supply of any or all of those services, if situated outside the Community, as being situated within their territory if the effective use and enjoyment of the services takes place within their territory.

However, this provision shall not apply to the electronically supplied services where those services are rendered to nontaxable persons not established within the Community.

Thus, new Article 59a is equally as broad as RVD 58. It allows a use and enjoyment standard in all transaction covered by the main B2B rule [Article 44], the main B2E and B2C rule [Article 45], the rule on hiring of means of transport [Article 56] and the exception for intangible services supplied to non-taxable persons [Article 59].

¹⁷ The German VAT Law 2005, §3a Place of Services (5) indicates:

The Federal Ministry of Finance may, with the permission of the Bundesrat, decree that in order to avoid double taxation or non-taxation or to prevent distortions of competition, that the services described in paragraph 4 no. 1 to 13 [all the intangible services listed in RVD 56(1) except for e-commerce services and the provision of access to, and of transport or transmission through, natural gas and electricity distribution systems and the provision of other directly linked services – RVD 56(1)(h) & (k)] and the rental of means of transport be considered to take place where they are used or enjoyed, in derogation from the conditions of paragraph 1 and 3. The place of the service can thus be treated as if it were

1. in a third country instead of within the country and
2. in the country instead of in a third country.

distribution systems and the provision of other directly linked services] to a legal person in public law established within the country, as long as he is not a business,

2. a service described in § 3a para. 4 no. 12 and 13 of the Law [telecom services and radio and television services], or
3. the hire of means of transport,

then this service shall, in derogation from § 3a Abs. 1 of the Law be treated as if it were carried out within the country, if it is used and enjoyed there. If the service is carried out by an establishment of a business, sentence 1 applies likewise if the establishment is located in a third country.

- (2) If a company that runs its business from within the country rents out a railway vehicle, a motor bus or a road vehicle exclusively intended for the transportation of goods, this service is considered, in derogation from § 3a Abs. 1 of the Law, to take place in the third country, if the service is rendered to a business established in a third country, the vehicle is intended for his business and is used outside the EU. If the rental of the vehicle is carried out from an establishment of a business, sentence 1 applies in the same way as when the establishment is located within the country.¹⁸

Exempt entities. The first concern is with purchases of intangible services by German exempt entities, or as the decree states, "...legal person(s) in public law established within the country, as long as [they are] not a business." Both non-taxation and distortion of competition are targeted with this provision. An example clarifies.

Assume a German municipality with a limited budget is considering leasing computers. If the municipality is offered the same lease terms by a German and an Icelandic firm the invoices will differ by 19%, the current standard VAT rate in Germany. If the municipality enters into the German lease, the German VAT will become part of its final cost. Exempt entities cannot deduct input VAT. However, if the municipality enters into the Icelandic lease there would be no VAT on the service at all. German VAT would not apply because the place of supply under RVD 43 is Iceland. Icelandic VAT would not apply because under Icelandic law the place of supply is deemed to be Germany. In addition to exempting the sale, the Icelandic provider is allowed to deduct the input VAT on these services, thus removing all traces of VAT from the transaction.¹⁹

The economics of the choice is clear – Icelandic providers are preferred over German. The choice distorts the marketplace – the cause of the distortion is the place of supply rules. The solution is for Germany to impose VAT based on use and enjoyment. This will get the right result. Germany is the place of final consumption.²⁰

¹⁸ Umsatzsteuer-Durchführungsverordnung in der Fassung der Bekanntmachung vom Feb. 21, 2005 (BGBl. I S. 434), last amended by Article 9 of the law dated Dec. 20, 2007 (BGBl. I S. 3150), available at : http://www.gesetze-im-internet.de/bundesrecht/ustdv_1980/gesamt.pdf; http://bundesrecht.juris.de/ustdv_1980/BJNR023590979.html (last visited Feb. 28, 2009) (in German, translation on file with author).

¹⁹ VALUE ADDED TAX ACT No. 50 at Art. 12(1) & (10) (1988) (with subsequent amendments) (Ice.)

²⁰ This provision will become redundant as of January 1, 2010. Changes in the design of the place of supply rules for services have the effect of making this aspect of the German derogation from the RVD standard throughout the EU.

Telecom services and radio and television services. The second concern is with telecom, radio and television services that are provided by businesses in third countries to customers that use and enjoy the service in Germany. As with the previous section where the use and enjoyment rule was limited to purchases by "...legal person(s) in public law established within the country, as long as [they are] not a business," this rule also has a limited application. It only alters the treatment of B2B transactions (although it appears to have a broader impact).

The overriding concern in this area is with losses of revenue and distortion of competition. Under the general rule (RVD 43) the place of supply for telecom services and radio and television services provided to EU customers by businesses located in a third country is the third country. This has been recognized as a problem area for a long time, and the problem was seen as most troubling when the *customer* was a *final consumer*.

RVD 59(1) and (2) solved part of this problem. Under RVD 59 (1) [for telecommunications services] and (2) [for radio and television] there is a mandate that all Member States apply the use and enjoyment criteria of RVD 58(b) and move the place of supply from outside the EU to within their territory.²¹

RVD 59(1) and (2) do not consider transactions with taxable persons (B2B). Thus, if a German business were to acquire these services from a provider located in a third country the place of supply would be deemed to be the seller's place. And if this third country were Iceland or the US, for example, then these services would carry no VAT at all.

Three provisions are important, new Article 43, 44 and 196. Article 43 provides a special definition of "taxable person." What this provision does is direct that exempt entities (or what the decree refers to as "... legal person in public law established within the country, as long as he is not a business") will be treated as a business for purposes of the place of supply of services rules. It indicates (emphasis supplied):

For the purpose of applying the rules concerning the place of supply of services:

1. a taxable person who also carries out activities or transactions that are not considered to be taxable supplies of goods or services in accordance with Article 2(1) shall be regarded as a taxable person in respect of all services rendered to him;
2. a non-taxable legal person who is identified for VAT purposes shall be regarded as a taxable person.

New Article 44 then indicates that the place of supply for services rendered to a taxable person (a category that now includes a non-taxable legal person who is identified for VAT purposes) is the location of the customer. It indicates (emphasis added):

The place of supply of services to a taxable person acting as such shall be the place where that person 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 shall be 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 shall be the place where the taxable person who receives such services has his permanent address or usually resides.

And finally, new Article 196 requires that Member States mandate that "taxable persons" who receive Article 44 services remit the tax under a reverse charge. It indicates (emphasis supplied):

VAT shall be payable by any taxable person, or non-taxable legal person identified for VAT purposes, to whom the services referred to in Article 44 are supplied, if the services are supplied by a taxable person not established within the territory of the Member State.

²¹ Although the time frame for RVD 59 appears limited, each year as the limitation on this requirement approached it is extended for another year. See Council Directive 2006/138/EC (Dec. 19, 2006) at Art. 1(3) extending the expiration date to December 31, 2008. Council Directive 2008/8/EC (Feb. 12, 2008) at Art. 1(3) further extending the expiration until December 31, 2009.

B2B transactions then are the real target of the Ministry of Finance’s decree (the treatment of other transactions had already been corrected). Under the derogation, if a business in a third country sells telecom services or radio and television services to a taxable person in the EU the place of supply will be Germany if the services are used and enjoyed in Germany.

There are three permutations of this basic fact pattern; one where the third country sale is made directly to a German business, and the use and enjoyment is in Germany; another is where the sale is made to a business in another Member States, but the use and enjoyment is in Germany; a third pattern is where the sale is made to a business in a third country, but the use and enjoyment is in Germany. These permutations can be diagrams as follows:

Figure 1. This is the basic permutation. A third country provider sells to a German business, and the use and enjoyment is in Germany.

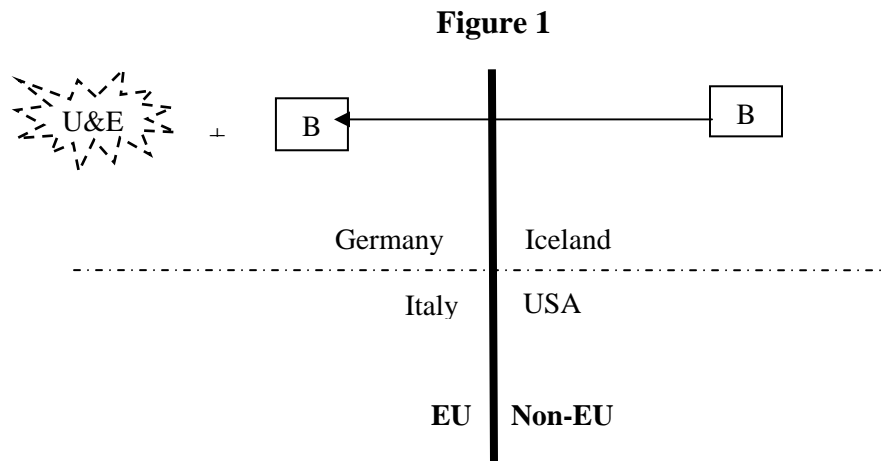
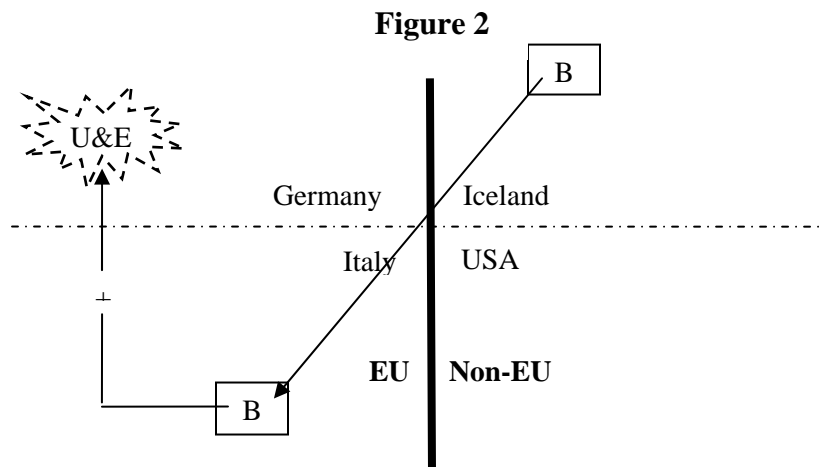


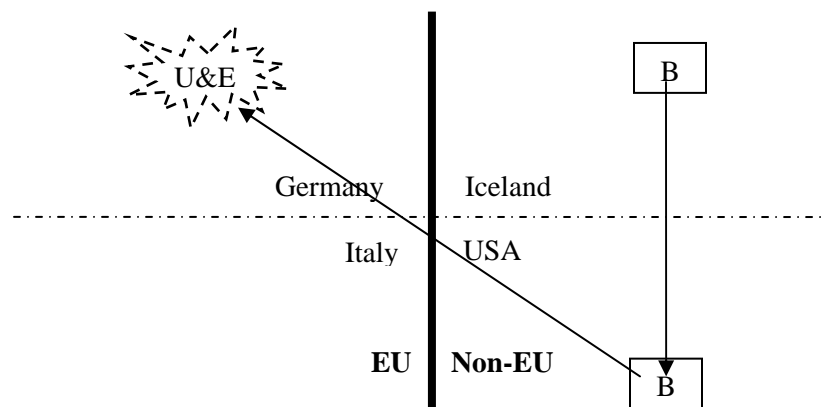
Figure 2. There is no requirement in the German derogation that the purchasing business be located in Germany. The only requirements are: (1) that the use and enjoyment is in Germany, and (2) that the supplier is located in a non-EU country. Thus, the same results arise when the purchasing business is located in Italy (instead of Germany), as long as the use and enjoyment is in Germany.



This pattern would lead to double taxation if the Italian VAT derogated from the main rule (RVD 43) by simply reversing the proxy, but this type of derogation is not permitted by RVD 58. Italy should not be allowed to impose VAT based on the buyer's location while Germany imposes VAT based on use and enjoyment of a service performed outside the EU.²² Thus, the only dispute that should arise between Germany and Italy over this transaction should be over which jurisdiction is the true place of use and enjoyment. There does not appear to be any case law on this situation.

Figure 3. It is also possible that sales from a third country (Iceland) to a business in another third country (USA) could be sourced in Germany if the telecom services or radio and television services are used and enjoyed in Germany.

Figure 3



The unlevel playing field remains. Perhaps the most important point in this entire area [covering both the purchase of intangible services by exempt entities, and the general purchase of telecom, television and radio services] is that even with this derogation, the German playing field is not level. The option is always available for these service providers to move their location from outside the EU to a Member State within the EU. In so doing, the place of supply becomes the location of the service provider (RVD 43). Use and enjoyment rules are no longer applicable.

Luxembourg therefore, with a VAT rate set at 15%, becomes the preferred location for these businesses. The VAT savings for German purchasers is 4%. The VAT loss for the German government is a full 19%, and the VAT windfall for the Luxembourg government is 15%.

As is the case for the rules impacting exempt entities,²³ the rules for telecom, television and radio services are also scheduled to change,²⁴ but not until 2015.²⁵ At that time the place of

²² This is however the case with Estonia. §10(2) of the Estonian VAT Act moves the place of supply for intangible services in B2B inbound transaction to Estonia. Thus, an Estonian business that purchased telecom or television or radio services from a non-EU provider, but used and enjoyed those services in Germany would be subject to both German and Estonian VAT on the same transaction. See *infra* text after note 40.

²³ See *supra* note 20.

supply for telecom services and radio and television services will be the customer's location in all instances. New Article 59a will continue to allow Member States to deem the place of supply to be within a Member State (if the normal rule determines it to be outside the EU) or deem the place of supply to be outside the EU (if the normal rules determines it to be within the Member State) based on use and enjoyment criteria. After 2015 Germany may still derogate (under new Article 59a) in the same manner it does today (under Article 58), if it is concerned about the revenue losses, or the distortion in competition represented by Figures 1, 2 and 3.

Leasing means of transport. The third aspect of the German derogation covers inbound and outbound leasing transactions.

Leasing means of transport – third country lessors (inbound use and enjoyment). The place of supply for hiring out means of transport is controlled by RVD 43.²⁶ Figures 1, 2 and 3 above apply to an inbound leasing scenario, although the lessor of cars or trucks will most likely be Swiss (rather than an Icelandic or American).

As was the case with telecom, radio and television services this derogation will not completely level the German playing field for leases of means of transport. It will equalize German lessors with third country lessors, but it will not level the playing field among the Member States. A Luxembourg lessor will impose a 15% VAT on the same lease that a German lessor would impose a 19% VAT.

Leasing means of transport – German lessors (outbound use and enjoyment). Under RVD 58(a) Member States are allowed to move the place of supply (that would otherwise be domestic under normal rules) outside the EU. The Federal Ministry of Finance's decree has exercised this option (§ 1 Abs.2 UStDV), but the scope of the provision is limited to railway vehicles, a motor buses or road vehicles exclusively intended for the transportation of goods. It

²⁴ A critical compromise in the efforts to change the place of supply for services is reflected in the 2008 VAT package – there will be no change between 2010 and 2015, but after 2015 the playing field will be leveled. COUNCIL DIRECTIVE 2008/8/EC specifies the transition from the present place of supply rules to the rules that will be used after 2015. There is considerable complexity in these rules between 2010 and 2015, where it takes five legal provisions to preserve the present system in a manner that can be easily adjusted (after 2015) into a far simpler system. The essential elements of the transitional rules are as follows. If the customer is a taxable person the default rule of *new Article 44* will apply (the place of supply is the customer's location). If the customer is a non-taxable person, the results turn on whether this customer is within or outside the EU. If this customer is outside the EU, the *new Article 59* applies (the place of supply is the customer's location). If the supplier is within the EU, then tax results depend on whether the supplier is located inside or outside the EU. If the supplier is outside the EU, then the default rule of *new Article 45* applies (the place of supply is the seller's location), but is overridden with *new Article 59b* requiring the application of *new Article 59a(b)* (moving the place of supply from outside the EU to inside a Member State based on use and enjoyment criteria). However, if the supplier is within the EU the default rule of *new Article 45* applies (the place of supply is the supplier's location).

²⁵ After 2015 the rules will be far simpler. The result will always be that the place of supply is where the customer is located. There will be two rules to get to this result. If the customer is a taxable person, the default rule of *new Article 44* will apply. If the customer is a non-taxable person, then *new Article 58* will apply.

²⁶ Prior to the adoption of the Tenth VAT Directive (July 31, 1984) Article 9(2)(d) treated the hiring out of means of transport as one of the miscellaneous services. It was removed, and the following explanation was placed in the preamble:

Whereas, however, as regards the hiring-out of forms of transport, Article 9(1) should, for reasons of control, be strictly applied, the place where the supplier has established his business being treated as the place of supply for such services.

OJ (L 208) 58, at preamble (July 31, 1984).

is further limited to leases rendered by German business to businesses established in a third country and only if the vehicle is intended for business use outside the EU. There is a further requirement of *actually use* outside the EU. The derogation does not extend to consumer leases.

The place of supply rules for inbound and outbound leases of means of transport will change in two waves – from January 1, 2010 and then again from January 1, 2013. Two distinctions will become important after January 1, 2010 (1) whether the lease was long-term or short-term, and (2) whether the customer was a taxable or non-taxable person. From 2013 forward special rules will be added for yachts distinguishing their treatment from that of all other vehicles when long-term leases are made to non-taxable persons. It will also be important whether the yacht is placed at the disposition of the buyer at the supplier's place of business or elsewhere.²⁷

The overall thrust of the new rules will be to change the place of supply (in most instances) from the location of the supplier to the location of the customer. These rules are proxy-based, not use and enjoyment based, and as a result there will still be issues (from a German point of view) in instances where vehicles will be used and enjoyed in Germany but not taxed there. This will occur where non-taxable persons enter into long-term leases of vehicles. New Article 45 will determine the place of supply as the seller's location (which could be a low VAT jurisdiction).

THE AUSTRIAN ADOPTION OF USE AND ENJOYMENT RULES FOR INTANGIBLE SERVICES

Austria also applies use and enjoyment to source the supply of some intangible services. It does so by statute, but more by decree. The statutory provisions target purchases made by exempt entities, like municipal government, hospitals, or schools. All intangible services purchased by these entities from suppliers in third countries are subject to Austrian VAT.

The rule is designed to shut down what has been called “the Iceland route” or “the Swiss route,” that has been popular with local governments that need to reduce costs (admittedly at the expense of distorting competition in the marketplace).²⁸

²⁷ Unlike the simplification of the place of supply rules for telecom services and radio and television services in COUNCIL DIRECTIVE 2008/8/EC, the changes made in the place of supply for leases of means of transport are becoming far more complex. The essential elements of the 2010 through 2012 rules indicate (*under new Article 56(1)*) that place of supply for short-term leases will be at the place at which the means of transport are put at the disposal of the lessee. If the lease is long-term, then if the customer is a taxable person *Article 44* will apply (making the place of supply the buyer's location). However if the customer is a non-taxable person then *Article 45* will apply (making the place of supply the seller's location).

The rules from 2013 forward will have additional refinements to the sourcing rules, but only if the customer is a non-taxable person. In this instance, for every vehicle other than a yacht *new Article 56(2)* applies (place of supply is where the customer resides). However for yachts a further distinction is drawn based on the place of disposal. If a yacht is placed at the disposal of the buyer at the supplier's place of business, then *new Article 56(3)* applies (the place of supply is the place of disposal). However, if the yacht is placed at the disposal of the buyer at any place else then *new Article 56(2)* applies (place of supply is where the customer resides).

Short-term rentals is a term that means continuous possession and use for a period of not more than 90 days (for vessels) or not more than 30 days (for other vehicles).

²⁸ BEN TERRA & JULIE KAJUS, A GUIDE TO THE EUROPEAN VAT DIRECTIVES (2008), Vol. 1, 584-85

The Austrian VAT Act authorizes the Federal Ministry of Finance to issue decrees that could apply the full range of use and enjoyment authority under RVD 58.²⁹ It has done so in three limited areas: (1) the leasing means of transport, (2) provision of staff, and (3) telecommunication services.

Leasing means of transport – outbound use and enjoyment only. Use and enjoyment criteria are used to move the place of supply outside the Community on leases of means of transport, RVD 58(a). Unlike Germany, RVD 58(b) is not applied to any inbound leasing transactions.

Like Germany, Austria is very specific about which transactions qualify for movement of the place of supply, but unlike the German focus on commercial leases, the Austrian derogation is more generally applicable. Germany lists railway vehicles, motor busses, and road vehicles – but only road vehicles that are exclusively intended for the transport of goods. Austria simply specifies “means of transport,” or “motor vehicles.” The Austrian derogation does concentrate on how proof of actual third country use and enjoyment must be demonstrated, and looks for permits, documentation, and visible evidence of third country identification. The decree by the Federal Minister of Finance indicates:

On the basis of § 3a Abs. 13 UStG 1994, it is decreed that:

§1. The place of service for the rental of means of transport is determined, under the following conditions, according to the place where the means of transport is used:

1. Use must be made of the vehicle in a third country.

²⁹ The Austrian VAT Act states:

§ 3a. Services

(11) If a company whose business is established in a third country renders a service described in paragraph 10 lines 1 to 14 [a reference that includes all miscellaneous services, except for e-commerce services, and the provision of access to, and the transport and transmission through, natural gas and electricity distribution systems and the provision of other directly linked services],²⁹ to a legal person in public law who is established within the country, then as long as this person is not a company or a person who hires out means of transport, then the service is carried out within the country, if it is used and enjoyed there. Likewise this applies if the service is carried out by an establishment located in a third country. ...

(13) The federal Ministry of Finance may, to avoid double taxation or non-taxation or to prevent distortions of competition, determine by decree that the place of a services named in paragraph 10 lines 1 to 14 [all intangible services listed in RVD 56(1) except for e-commerce services and the provision of access to, and of transport or transmission through, natural gas and electricity distribution systems and the provision of other directly linked services – RVD 56(1)(h) & (k)] and the place of service for the hire of means of transport, in derogation from the conditions of paragraph 9 [the rules that set the place of supply at the location where the recipient of the service is established] and paragraph 12 [the fall-back rule that determines all other services to be supplied where the supplier is established], is to be located where the service is used or enjoyed. The place of the service can thus be treated as if it were

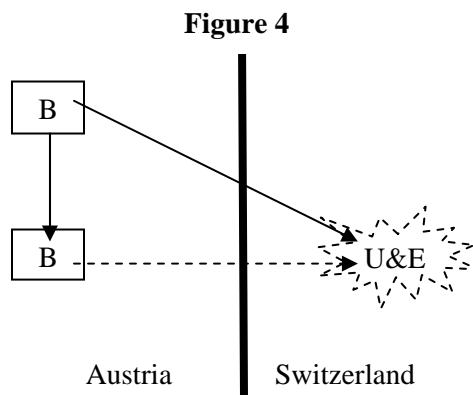
1. in a third country instead of within the country and
2. in the country instead of in a third country.

2. For motor vehicles and trailers, the permit for a motor vehicle must be obtained in the third country. Motor vehicles must therefore display identification from a third country.
 3. If the means of transport is also Community property, an export declaration must also be present with the exit certificate from Customs.
- §2. When renting out railway goods wagons (including railway tankers) to businesses outside the European Union, the place of service is the place where the railway goods wagon is mainly used, if this use takes place outside the territory of the European Union.³⁰

Provision of staff – outbound use and enjoyment only. Another decree moves the place of supply for the provision of staff from Austria to a third country. The controlling provision is the location of employment, RVD 58(a). The decree of the Federal Minister of Finance states: The place of service for the provision of staff is moved from within the country to a third country, if the staff provided are employed in a third country.³¹

Two fact patterns cover the permutations of this derogation: (a) a domestic contract for the provision of staff (figure 4); and (b) an intra-community contract for the provision of staff (figure 5). In both instances actual employment of the personnel is outside the Community.

In figure 4 an Austrian business agrees to provide staff for a second Austrian business at the Swiss facility owned by the second business. Even though this service should have an Austrian place of supply (it is a domestic contract), the decree of the Minister of Finance removes this supply from the Austrian VAT.

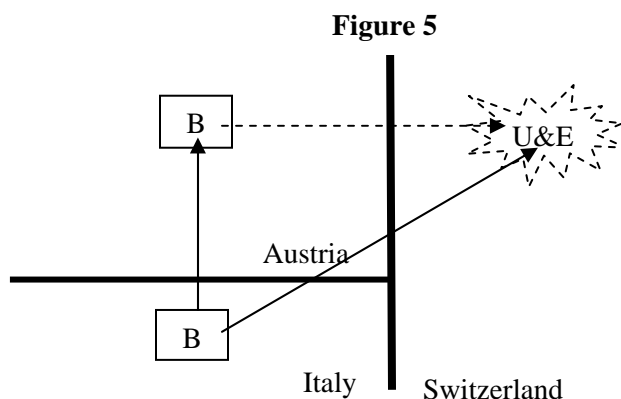


In figure 5 an Italian business agrees to provide staff for an Austrian business at the Swiss facility of the Austrian business. Even though this service should have an Austrian place of

³⁰ Verordnung des Bundesministers für Finanzen über die Verlagerung des Ortes der sonstigen Leistung bei der Vermietung von Beförderungsmitteln BGBl. Nr. 5/1996 (Jan. 5, 1996) available at: http://www.ris2.bka.gv.at/Dokumente/BgblPdf/1996_5_0/1996_5_0.pdf (last visited Feb. 28, 2009) (in German, translation on file with author).

³¹ Verordnung des Bundesministers für Finanzen über die Verlagerung des Ortes der sonstigen Leistung bei der Gestellung von Personal, BGBl. II Nr. 218/1998 (Jul. 9, 1988) available at: http://www.ris2.bka.gv.at/Dokumente/BgblPdf/1998_218_2/1998_218_2.pdf (last visited Feb. 28, 2009) (in German, translation on file with author).

supply (RVD 56(1)), the degree of the Minister of Finance removes this supply from the Austrian VAT.



Telecommunications services – inbound use and enjoyment only. A third decree concerns telecommunications services. As with the similar German derogation this decree endeavors to level the playing field by moving the place of supply for inbound telecommunications services to a location within Austria, if use and enjoyment is in Austria. As with the German derogation this decree fails to fully level the playing field, because providers established in other Member States will charge VAT at origin. Thus a Luxembourg established firm would charge Austrian customers at 15% where other firms would collect the 20% Austrian VAT. The decree states:

On the basis of § 3a (10) Z 13 and 14 as well as (13) of the Umsatzsteuergesetz 1994, BGBl. No 663/1994, in the version under Federal Law BGBl. I, 71/2003, it is provided as follows:

§ 1. Whenever the place of performance of a service defined in § 3a (10) Z 13 and 14 of the Umsatzsteuergesetz 1994 lies outside of the Community pursuant to § 3a of the Umsatzsteuergesetz 1994, the service shall be deemed to be performed on national territory if it is used or exploited on national territory.

§2. “Telecommunications services” refers to services ensuring transmission, emission or reception of signals, words, images and sounds or information of any nature by wire, radio, optical or other electromagnetic media; including transfer or assignment of usage rights to establishments for such transmission, emission or reception.³²

Even though the rules in this area are expected to change (after 2015) the telecommunications rules will remain proxy-based and as a result Austria may still feel a need to derogate. The three instances where this might be necessary were considered under the German section in Figures 1, 2 and 3.

THE DANISH ADOPTION OF

³² Verordnung des Bundesministers für Finanzen über die Verlagerung des Ortes der sonstigen Leistung bei Telekommunikationsdiensten sowie Rundfunk- und Fernsehdienstleistungen, BGBl. II Nr. 383/2003 (Aug. 21, 2003) available at: http://www.ris2.bka.gv.at/Dokumente/BgblPdf/2003_383_2/2003_383_2.pdf (last visited Feb. 28, 2009) (in German, translation on file with author).

USE AND ENJOYMENT RULES FOR INTANGIBLE SERVICES

Danish adoption of use and enjoyment contrasts markedly with the selective adoption seen in Germany and Austria. Sweepingly broad and balanced, the Danish law assimilates the full scope of the derogation allowed by RVD 58. Where Germany and Austria largely retain the proxy system, Denmark has replaced the proxy regime with use and enjoyment sourcing of intangible services. At a policy level the Danish decision is that this is the best way to source these services.

There is one caveat. In one respect the Danish rules are more limited than what RVD 58 would allow. RVD 58 focuses purely on the location of (the use and enjoyment of) intangible services. The Danish rules have one thing more. They have a nexus element – that is, the location of the *purchaser* must coincide with the location of *use and enjoyment*. It is not sufficient for the purchaser to be located in Denmark, nor is it sufficient for the use and enjoyment to be located in Denmark. Both must be there.

Danish adoption of RVD 58(b) – inbound use and enjoyment. Denmark moves the place of supply for intangible services from outside the EU to Denmark, if the services are supplied to Danish purchasers and the intangible services are used and enjoyed in Denmark. The words of the VAT Act are:

- (3) The place of supply of services, which are summed up in para. 2 and supplied from outside the EU, is in this country in the following cases:
 - 1) When the services named in para. 2 nos. 1-10 and 12 [referring to all intangible services, except for e-commerce services], are supplied to purchasers in this country, if effective use and enjoyment of the service takes place in this country
 - 2) When the services named in para. 2 no 11 [e-commerce services] are supplied to purchasers in this country.³³

The breadth (and limitations) of the Danish rules can be seen if figures 1, 2, and 3 (from the German section) are adapted to fit the Danish derogation. Figure 1 presented a non-EU business providing telecommunications services and radio and television services to German businesses. The main rule, under RVD 43, locates the place of supply outside the EU, based on the place where the supplier has established his business. Figure 1 considered only B2B transactions, because RVD 59(1) and (2) had already mandated use and enjoyment criteria in other cases. All that was left for the German derogation to modify was B2B.

Figure 6. All intangible services (not just telecommunications services and radio and television services) are included in Figure 6. All classes of transactions are involved (not just B2B transactions). Danish VAT will apply if *any* “purchaser in this country” uses and enjoys *any* of the intangible services listed in RVD 58(1). Figure 6 indicates that if a business established in Iceland supplies any intangible service to any Danish customer who then uses and enjoys the service in Denmark, the Danish VAT will apply.

³³ Danish VAT Act, Ch. E.3.1.3, §15, para. 2, no. 3, *available at*: <http://www.skat.dk/SKAT.aspx?oId=96152&vId=202195&i=403#96152> (last visited Feb. 28, 2009) (in Danish, translation on file with author).

Figure 6 [based on Figure 1]

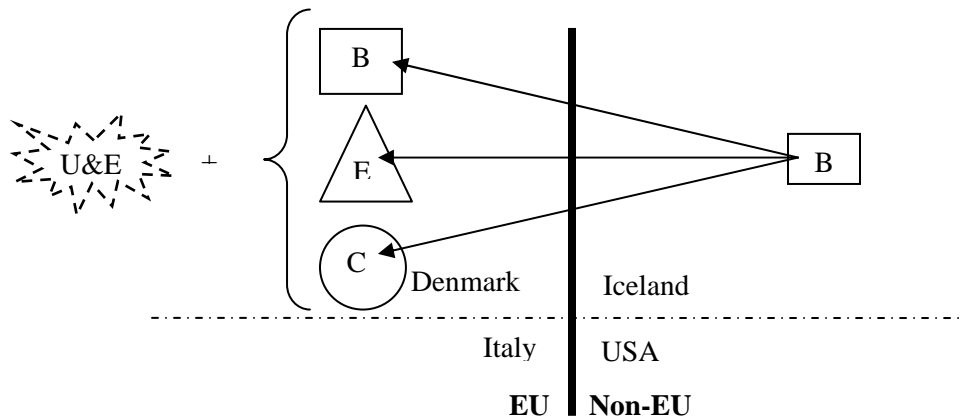


Figure 7. As we did in Figure 2 earlier, if we assume that the Iceland business supplies services to Italian customers (instead of Danish customers), and if we further assume that these services are used and enjoyed in Denmark, then Danish VAT will not apply. Figure 7 presents this scenario.

The result in Figure 7 is different than the result in Figure 2. German VAT applied to the transaction sketched in Figure 2 because the German derogation does not require that the customer be located (established) in Germany. It is sufficient that the use and enjoyment arise in Germany. In the Danish context however, Danish VAT will not apply if the purchaser is not “in this country.”

Figure 7 [based on Figure 2]

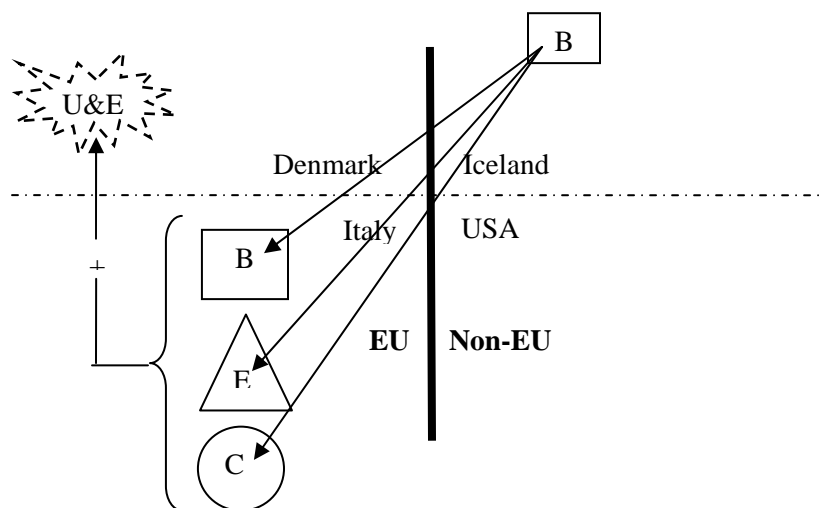
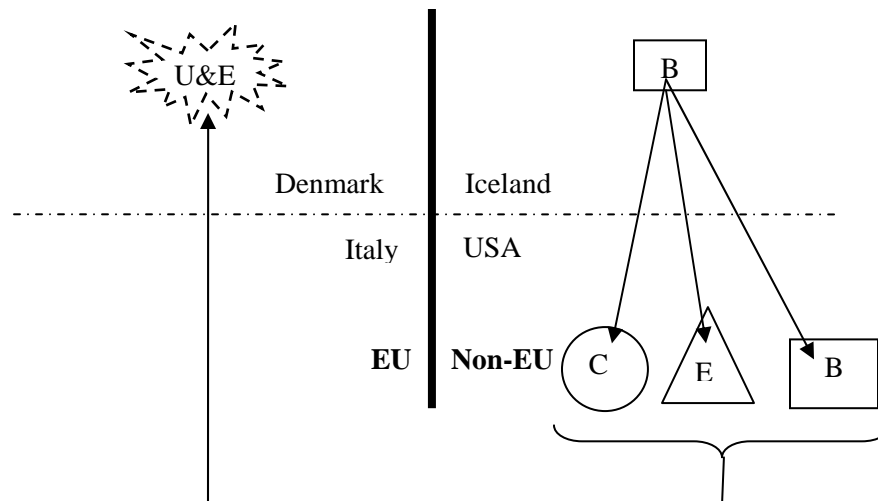


Figure 8. The same result arises if Figure 3 is adapted to a Danish context. In this figure we assumed that the Iceland business supplied services to a non-EU customer (located in the US), and this customer used and enjoyed the service in Germany. German VAT applied in figure 3 simply based on the location of the use and enjoyment.

The result in Figure 8 differs from the result in Figure 3 because there is a requirement in the Danish law that the customer must be “in this country,” and in this scenario this is clearly not the case. Danish VAT will not apply in Figure 8.

Figure 8 [based on Figure 3]



Danish adoption of RVD 58(a) – outbound use and enjoyment. The Danish rules move the place of supply for intangible services (which would otherwise be sourced within Denmark) to a location outside the EU if the purchaser of the services is outside the EU, *or* if the services are used and enjoyed outside the EU.³⁴ The Danish derogation is included in a longer statutory provision which reads in full:

- (4) The place of supply of services summed up in para. 2 and which are supplied by a taxable person in this country, is not in this country in the following cases:
- 1) When the services named in para. 2 nos. 1-10 and 12 [referring to all intangible services, except for e-commerce services], are supplied to purchasers in this country, if effective use and enjoyment of the services takes place outside the EU
 - 2) When the services named in para. 2 nos. 1-12 [all intangible services] are supplied to a taxable person in another Member State
 - 3) When the services named in para. 2 nos. 1-10 and 12 [referring to all intangible services, except for e-commerce services], are supplied to non-taxable persons in another Member State, if effective use and enjoyment of the services takes place outside the EU
 - 4) When the services named in para. 2 nos. 1-10 and 12 [referring to all intangible services, except for e-commerce services], are supplied to

³⁴ The Danish rules are consistent. RVD 58(b) is transposed into Danish law conjunctively. The customer must be in Denmark *and* the services must be used and enjoyed in Denmark for the VAT to apply. RVD 58(a) is transposed into Danish law disjunctively. If either the customer or the services are use and enjoyment is outside of Denmark, then the Danish VAT will not apply.

purchasers outside the EU, while effective use and enjoyment of the services takes place in this country

- 5) When the services named in para. 2 no 11 [e-commerce services] are supplied to purchasers outside the EU.³⁵

The following figures illustrate these provisions: Figure 9 applies §13(4)(1); Figure 10 applies §13(4)(2) and (3); Figure 11 applies §13(4)(4) and (5).

Figure 9. If any intangible service (other than e-commerce services) are provided by a Danish business to any Danish purchaser (B2B, B2E or B2C transactions are all included) the service is *not* subject to Danish VAT if the service is used and enjoyed outside the EU. Set in a concrete scenario, a Danish accountant could provide Icelandic tax preparation services to a Danish business, exempt entity or individual. Because these tax returns are filed in Iceland, the use and enjoyment of the tax preparation services are outside the EU. There will be no Danish VAT on the accountant's invoice.

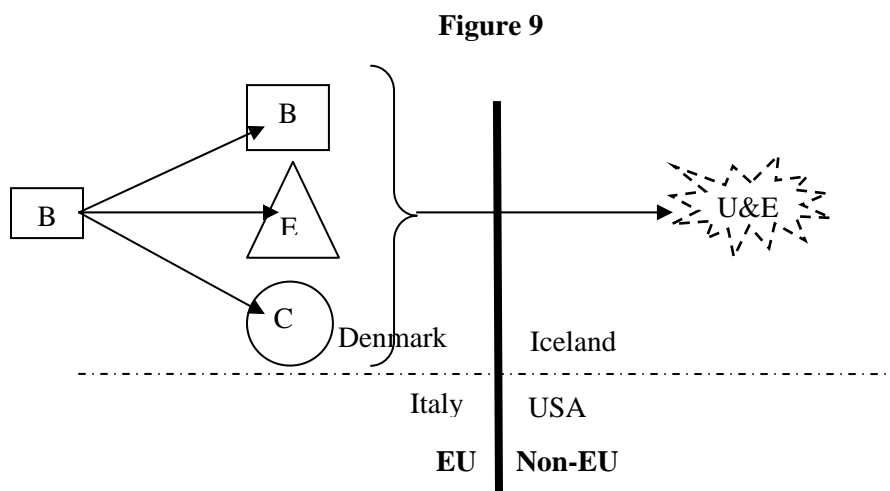


Figure 10. The rules under §13(4)(2) and (3) will be considered together. §13(4)(2) is the transposition into Danish law of RVD 58(1). It indicates that all intangible services provided by a Danish business to a business in another Member States are deemed to be supplied at the customer's location – outside of Denmark. §13(4)(3) is the related use and enjoyment derogation. It extends the previous rule to the provision of intangible services to non-taxable entities (exempt entities and individual consumers), but only if these services are used and enjoyed outside the EU.

To set this figure 10 into a concrete scenario, assume that the service provider is a Danish law firm, and the service is litigation related. If these services are provided to three kinds of Italian clients (businesses, exempt entities and individual consumers), then the results are: (1) the services provided to the Italian businesses are not subject to Danish VAT regardless of where they are used and enjoyed; and (2) the services provided to exempt Italian entities and Italian

³⁵ Danish VAT Act, Ch. E.3.1.4, §15, para. 2, no. 4. Available at: <http://www.skat.dk/SKAT.aspx?oId=96152&vId=202195&i=403#i96152> (last visited Feb. 28, 2009) (in Danish, translation on file with author).

individuals are not subject to Danish VAT if they are used and enjoyed outside the EU. In this second instance the assumption might be that the litigation is taking place in Iceland.

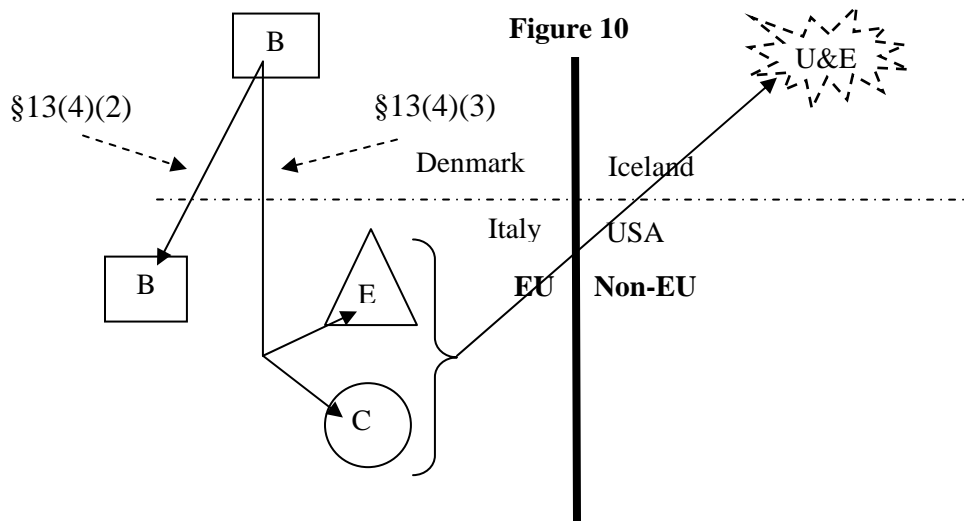
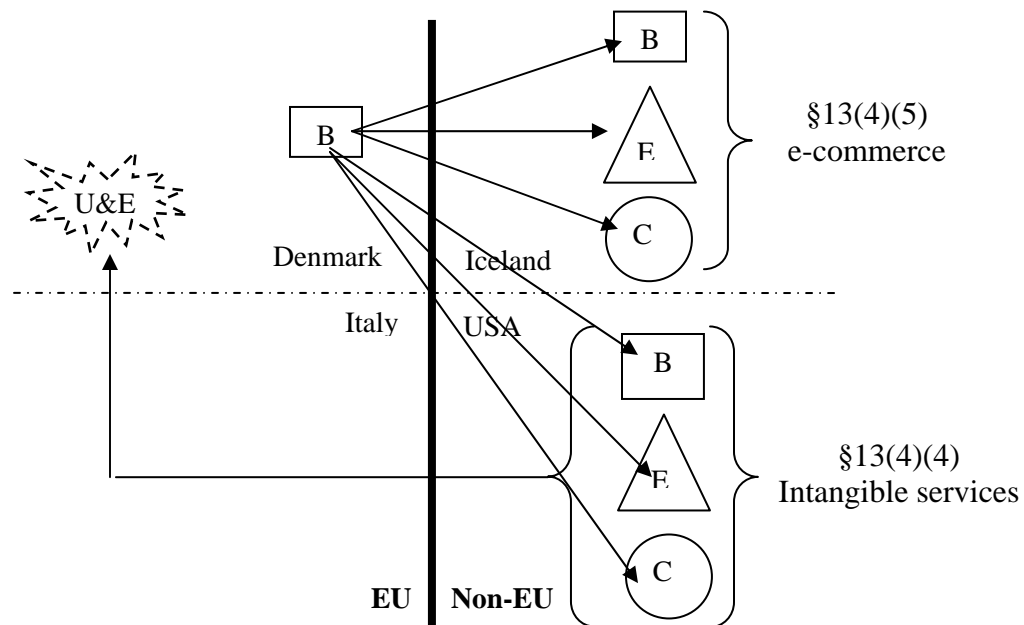


Figure 11. The rules under §13(4)(4) and (5) are also considered together. §13(4)(5) is the transposition into Danish law of RVD 58(1) with respect to e-commerce services. It indicates that the place of supply of e-commerce services provided by a Danish business to a purchaser outside the EU is outside of Denmark. The place of use and enjoyment of e-commerce services does not change this result. For all other intangible services provided to any purchaser outside of the EU §13(4)(4) indicates that Danish VAT will not apply even if the services are used and enjoyed in Denmark. In other words, use and enjoyment within Denmark is not sufficient to bring services within the ambit of the Danish VAT (even though they are provided by Danish firms). It is essential under Danish rules that the purchaser be “in this country.”

A concrete example for this scenario would be a Danish technology firm that provides both internet hosting and web design for internet advertizing services. If non-EU customers contacted this firm to help it enter the Danish market, then internet hosting services provided to Icelandic purchasers would not be subject to Danish VAT, §13(4)(5). If American customers also solicited this Danish firm for help designing Danish-language advertizing for posting on Danish web sites, then no Danish VAT would be applied to the invoice, §13(4)(4). This would be true even though the service provider is Danish and the use and enjoyment is Danish. Danish law requires the purchaser to be “in this country.”

Figure 11

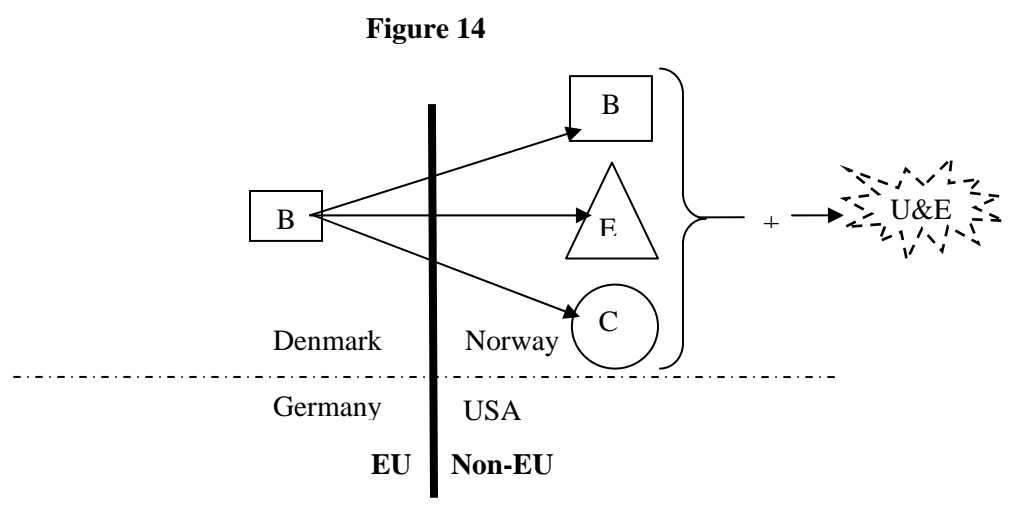
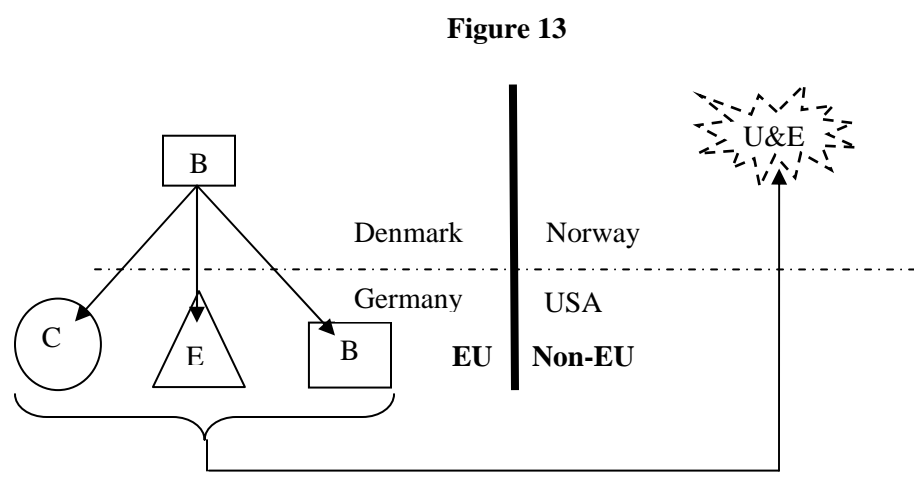
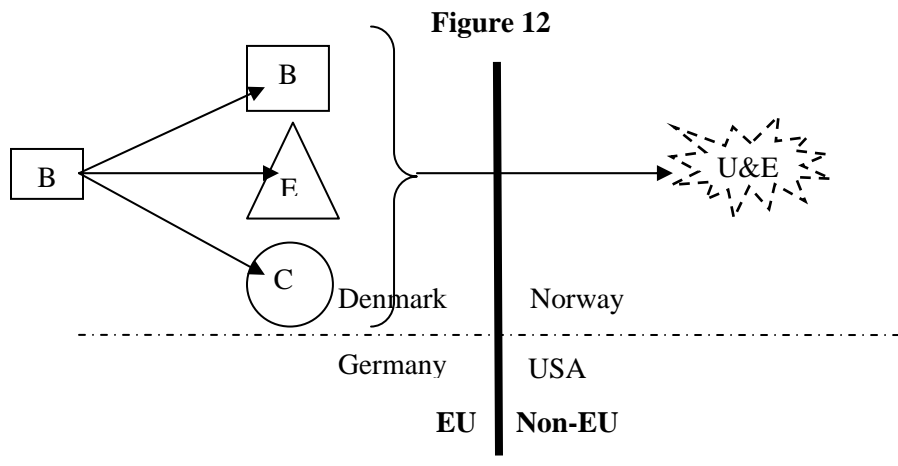


Danish rules on hiring out means of transport – inbound and outbound use and enjoyment. RVD 58 includes the service of hiring out means of transport among the intangible services potentially subject to use and enjoyment. The Danish adoption of use and enjoyment criterion for determining the place of supply of these services is found at § 16(1) and (2) of the Danish VAT Act. It reads as follows:

- (1) The place of supply for the hiring out of means of transport is not in this country, if the means of transport is effectively used outside the EU (see §15, para 1) ...
- (2) The place of supply for hiring out of means of transport to taxable persons is in this country when the services are supplied by a taxable person outside the EU and the means of transport is effectively used in this country.³⁶

The basic rule for the place of supply for the hiring out means of transport is the location of the lessor, RVD 43. This rule does not change based on the location of the lessee or the tax-status of the lessee. Thus §16(1) changes the place of supply in three situations. Assuming the lessor is established in Denmark, the place of supply will not be in Denmark if (a) the purchaser is in Denmark, but use and enjoyment is outside the EU; (b) the purchaser is in another EU Member State, but use and enjoyment is outside the EU; (c) the purchaser is outside the EU, and use and enjoyment is outside the EU. Figures 12, 13 and 14 demonstrate these situations.

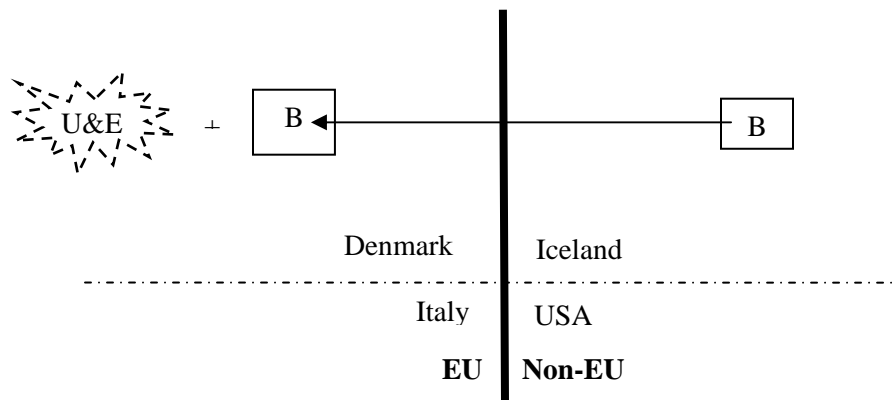
³⁶ Danish VAT Act, Ch. E.3.2, §16, para. 1 & 2, available at: <http://www.skat.dk/SKAT.aspx?oId=96152&vId=202195&i=403#96152> (last visited Feb. 28, 2009) (in Danish, translation on file with author).



The place of supply for the hiring out of means of transport moves from outside the EU to within Denmark only when a lessor (outside of the EU) leases to a business within Denmark, and the use and enjoyment of the lease occurs within Denmark, §16(2). This rule does not apply when the purchaser is an exempt entity or an individual consumer. It also does not apply in situations (like those set out in Figures 7 and 8) where an application of normal sourcing rules would determine that the place of supply is outside the EU although use and enjoyment is within Denmark.

It is critical that lessee be “in this country” for the place of supply to move within Denmark. This is a limited application of RVD 58(b). It is consistent with the other Danish rules under §15(1), rules that are applicable to all intangible services (except e-commerce services). Figure 15 presents the §16(2) scenario:

Figure 15



This leaves Denmark in exactly the same situation as Germany and Austria with respect to a level the playing field in the leasing of means of transport marketplace. The Danish case however is more compelling because there is a 10% differential between the Danish (25%) and Luxembourg (15%) VAT rates.

Thus, a Danish lessor will impose 25% VAT on all lease transactions with Danish customers, as long as the use and enjoyment of the lease is within Denmark (figures 12-14 above). In addition a Danish business that enters into leases with non-EU lessors will also carry the 25% Danish VAT, provided use and enjoyment is within Denmark (figure 15 above). However, if the lessor is established in Luxembourg (and if the lessor has no fixed establishment in Denmark from which the service is rendered³⁷) only a 15% VAT will apply. This inequality will be resolved in two waves of revisions to the RVD – January 1, 2010 and January 1, 2013.³⁸

³⁷ ARO Lease BV v. Inspecteur der Belastingdienst Grote Ondernemingen, Amsterdam, C-190/95, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61995J0190:EN:HTML> (holding that a Luxembourg established car leasing enterprise with no fixed establishment in the Netherlands was properly charging Luxembourg VAT on leases to of vehicles that were used and enjoyed in the Netherlands).

³⁸ See *supra* note 27. The 2008 VAT package allows the present system to remain in place until January 1, 2010 – vehicle rentals are subject to VAT at the place where the supplier is established. From January 1, 2010 short-term rentals must be distinguished from long-term rentals, and proxies based on (1) the location of the lessor [long-term leases to non-taxable persons], (2) the lessee [long-term leases to taxable persons], and (3) where the vehicle is

Danish reverse charge rules. One of the more significant administrative consequences of the broad Danish adoption of use and enjoyment criteria is the impact that these rules have had on non-EU suppliers. Prior to January 1, 2009 it was always necessary for foreign suppliers to register, collect, and remit Danish VAT when intangible services had a place of supply in Denmark.³⁹ The VAT Act now provides:

If a taxable person purchases from a supplier, who is established abroad, services mentioned in the VAT Act, Section 15, paragraph 2 and 3, Section 16, paragraph 2, § § 17-21, the VAT is to be settled paid by the taxable person. ... If the customer is a private person, the foreign supplier is required to register in this country and pay VAT on the supply.⁴⁰

The reverse charge is mandatory, and applies in all cases whether the buyer is registered for VAT or not. Only in instances where a foreign person is selling intangible services to individual customers is a foreign provider still required to register, collect and remit VAT on Danish sales. There is no minimum registration threshold in Denmark.

THE ESTONIAN ADOPTION OF USE AND ENJOYMENT RULES FOR INTANGIBLE SERVICES

There are two parts to the Estonian adoption of use and enjoyment to determine the place of supply for intangible services and neither is standard. One appears to be a direct adoption of RVD 58(b), the other an indirect adoption.

Direct adoption of RVD 58(b) – inbound transactions. The underlying premise for RVD 58's permissive derogation for determining the place of supply through use and enjoyment criteria is that in some instances (and for some jurisdictions) the standard proxy-based rules do not achieve the correct result. There are only four basic proxy rules. They are either supplier or customer centric – (a) the place of establishment; (b) the place of a fixed establishment – from which or to which – a service is supplied; (c) the place of permanent address; and (d) the place of residence.

When a jurisdiction adopts the use and enjoyment criteria we are not simply switching proxies. The design is *not* to move from the supplier-centric to the customer-centric proxies. Use and enjoyment requires something different. It requires that a determination be made on where "... the effective use and enjoyment of the services [actually] takes place ..." This can sometimes be a difficult, fact-intensive inquiry. Estonia however, has not done this.

placed at the disposal of the customer [all short-term leases]. After January 1, 2013 long-term leases to non-taxable persons will be sourced to the lessee's location, with the exception of yachts, which will use a proxy of the place of disposal.

³⁹ Elsebeth Hjortshøj Rasmussen & Nikolaj Bjørnholm, *Parliament Adopts New VAT Act*, 51 TAX NOTES INT'L 152 (Jul 14, 2008).

⁴⁰ Danish VAT Act, Ch. L.1.2.3, §46, para.1, no. 3, *available at*: <http://www.skat.dk/SKAT.aspx?oId=96152&vId=202195&i=403#i96152> (last visited Feb. 28, 2009) (in Danish, translation on file with author).

At §10(2) the Estonian VAT Act determines that *Estonia* is the place of supply for intangible services *received* by an Estonian taxable person, or an Estonian taxable person with limited liability. This is a broad provision. It includes not only intra-community transactions [conforming with the RVD 56(1) proxy], but it also includes *inbound* transactions from non-EU suppliers [in apparent conflict with the RVD 43 proxy]. The only way to justify the inbound aspects of this provision is to suggest that this is the transposition into Estonian law of RVD 58(b). The VAT Act states:

§10 Place of supply of services ...

(2) The place of supply of services is Estonia if the following services are provided to a taxable person or taxable person with limited liability registered in Estonia:

- 1) grant of the use of intellectual property or transfer of the right to use intellectual property;
- 2) advertising services;
- 3) services of consultants, accountants, lawyers, auditors and engineers, and translation services, as well as data processing and the supplying of information;
- 4) financial services, except for leasing safes, or insurance services, including reinsurance and insurance intermediation services;
- 5) allowing use of manpower;
- 6) the hiring or leasing of or establishment of a usufruct on movables, except means of transport;
- 7) electronic communications services, including assignment of rights to use transmission lines;
- 8) (Repealed)
- 9) electronically supplied services;
- 10) intermediation;
- 11) work with movable located in another Member State if after the provision of the service, the movable is taken out of that Member State;
- 12) transport services for goods from one Member State to another, including the carriage of goods to or from Estonia, services for the organisation of such transport of goods and ancillary services related to such transport of goods;
- 13) transport services for goods provided within Estonia if they are part of carriage operations which begin or end in another Member State, services for the organisation of such transport of goods and ancillary services related to such transport of goods;
- 14) allowing access to natural gas and electricity network connections, or transmission of natural gas or electricity through networks and services directly related thereto;
- 15) refraining from receipt of the services specified in clauses 1)-10), 14) and 16) of this subsection, waiving the exercise of a right or tolerating a situation for a charge;
- 16) transfer of permitted limit values of emissions of greenhouse gases regulated by the Ambient Air Protection Act.

Although the identified services are the specified intangible services that can be sourced with use and enjoyment criteria, there is no indication that Estonia has made the application of

this provision *in its inbound aspect* contingent on a locational determination of effective use and enjoyment in Estonia. If §10(2) were limited to domestic transaction or to intra-community transactions between taxable persons established in the Community but not in the same country, then there would be nothing exceptional here.

Nevertheless, the only way to understand the Estonian place of supply rules for intangible services in §10(2) as they apply to non-EU suppliers to Estonian customers is to see them in the context of RVD 58(b) as an application of the use and enjoyment option. They are consistent with community law *only if* we assume that when “services are provided to an [Estonian] taxable person or [a] taxable person with limited liability registered in Estonia” that these services are also used and enjoyed in Estonia.

Indirect adoption of RVD 58(b) – inbound transactions. One of the other unique attributes of the Estonian VAT is the classification that certain enterprises are *taxable person with limited liability*. This classification depends on the receipt of intangible services by an Estonian entity.

An Estonian *taxable person with limited liability* functions very much like a PE in the Czech Republic. The Czech PE is a locus for the application of the reverse charge when intangible services are sourced to the Czech Republic under use and enjoyment criteria. The Estonian VAT has a similar linchpin.

The key to the Estonian rules in this area is the determination that the PE of a foreign enterprise in Estonia that *receives intangible services* from a foreign business is deemed to be a *taxable person with limited liability* in Estonia. A PE cannot be a *taxable person with limited liability* in Estonia if the foreign enterprise itself is registered as a taxable person in Estonia.

This classification (*taxable person with limited liability*) carries with it a series of obligations: (a) to register for VAT on the date the service is received;⁴¹ (b) to file necessary VAT returns;⁴² and (c) to remit VAT due on the intangible services received (a reverse charge mechanism).⁴³

Deeming the PE of a foreign enterprise (that is not itself registered as an Estonian taxable person) to be an Estonian taxable person has three notable consequences:

- It effectively moves the place of supply of intangible services (that are provided from outside the EU) to within Estonia (even though the provider and customer of those services are both non-EU established enterprises), if the customer has a PE in Estonia that receives the services. This action *mimics* the application of use and enjoyment criteria under RVD 58(b). See Figure 16.
- It effectively moves the place of supply of intangible services (that are provided from outside the EU) to within Estonia (when the provider of those services is a non-EU service provider, and the customer is established within the Community). This result also

⁴¹ VAT Act §21(1) (Est.) available at: <http://www.legaltext.ee/en/andmebaas/ava.asp?m=026>

⁴² VAT Act §3(5) (Est.).

⁴³ VAT Act §3(4)(2) (Est.).

mimics the application of the use and enjoyment criteria under RVD 58(b). See Figure 17.

- *But it also* creates an unfortunate ambiguity in the determination of the place of supply for intangible services provided within the EU. It is “unfortunate,” because there is a strong possibility of double taxation. The proxies under RVD 56(1) that apply to intra-Community supplies source intangible services at both the place of establishment of the customer and the place where the customer has a fixed establishment at which the services are received. Selecting between these alternate proxy locations has been difficult on occasion.⁴⁴ However, Estonia’s determination that a *taxable person with limited liability* is established in Estonia, along with a mandatory reverse charge on intangible services received by this enterprise raised this conflict to a new level. An Estonian reverse charge may apply on the same facts that require a different jurisdiction’s VAT to be placed on the invoice. See Figure 18.

Specific examples are helpful.

Figure 16. Assume that a Swiss company (that is not registered as a taxable person in Estonia) contracts with an American advertising firm for services in developing an advertising campaign for its products in Estonia. The place of supply of these services is either in the US or Switzerland, but not in Estonia. RVD 43, for example, would place these services in the US.

If however, the Swiss firm has a PE in Estonia, and if the PE “receives” the benefit of these advertising services (Estonian VAT Act §21), then on the date the PE receives these services it is obliged to register as a *taxable person with limited liability*. Once registered it must file the necessary VAT returns, and remit the Estonia VAT through a mandatory reverse charge.

It is the requirement that the PE “receives” the intangible services that makes the Estonian rules most like the use and enjoyment criteria under RVD 58(b). The words “use and enjoyment” do not appear in the statute, but the provision essentially *mimics* RVD 58(b).

The Estonian rules echo the Czech Republic rules that also rely on PEs to shift the place of supply on intangible services from outside the EU to within the Czech Republic. The major difference between these uses is that the Estonian rules require that the PE “receive” the intangible service whereas the Czech Republic rules simply require there to be a PE within the country (whether or not the intangible services are related to the PE or not).⁴⁵ Figure 16 illustrates this result.

⁴⁴ *Burkholz v. Finanzamt Hamburg-Mitte-Alstadt* Case 168/84; [1985] ECR 2251 (concerning the place of supply for the “takings” from gaming machines placed on a ferry operating between Germany and Denmark by a German established company and whether the boat as a fixed establishment took precedence over the Hamburg, Germany place of establishment); *Customs and Excise Commissioners v. DFDS A/S* Case 260/95; [1997] STC 384, [1997] ECR I-1005 (concerning a Danish established tour operator that marketed tours in the UK through its agent, a UK company, and which found based on the actual economic situation that the place of supply was at the UK agent, the fixed establishment)..

⁴⁵ See *supra* note 4 and accompanying text.

Figure 16

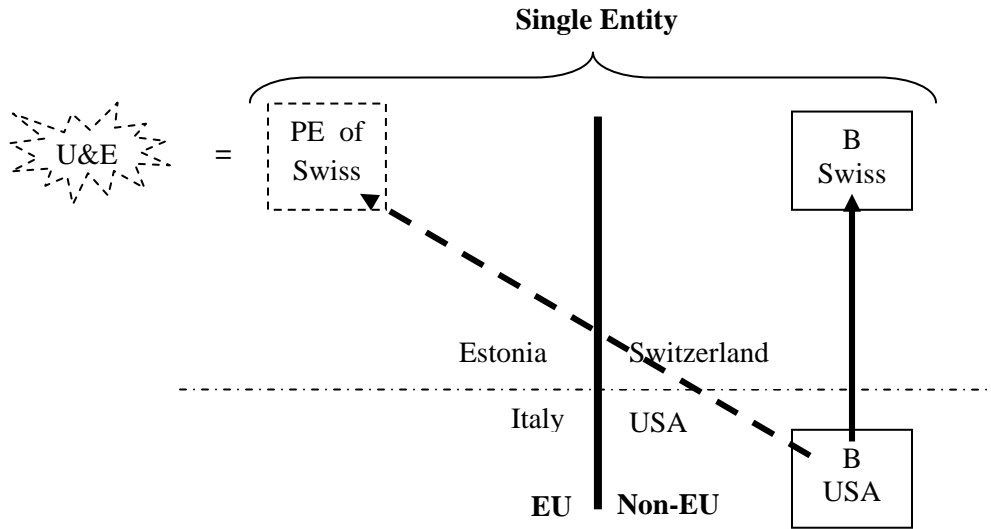


Figure 17. Assume that an Italian company (that is not registered as a taxable person in Estonia) contracts with a Swiss advertising firm for services in developing an advertising campaign for its products in Estonia. Assume further that these services are “received” by the Italian firm’s PE in Estonia.

Under normal circumstances the place of supply for these services would be at the supplier’s location in Switzerland (RVD 43). However, the presence of a PE in Estonia makes the PE a *taxable person with limited liability* and obliges it to collect Estonian VAT as a reverse charge. As with the Figure 16, the fact that the PE “receives” the intangible services and thereby effectuates a change in the place of supply from outside the EU to within Estonia makes these Estonian rules *mimic* the use and enjoyment criteria under RVD 58(b). Figure 17 presents this scenario.

Figure 17

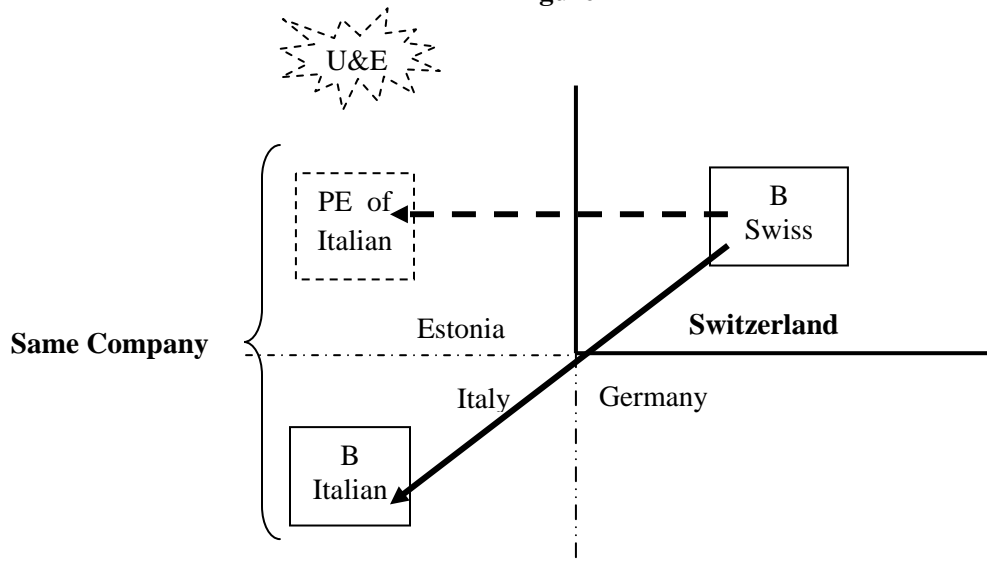
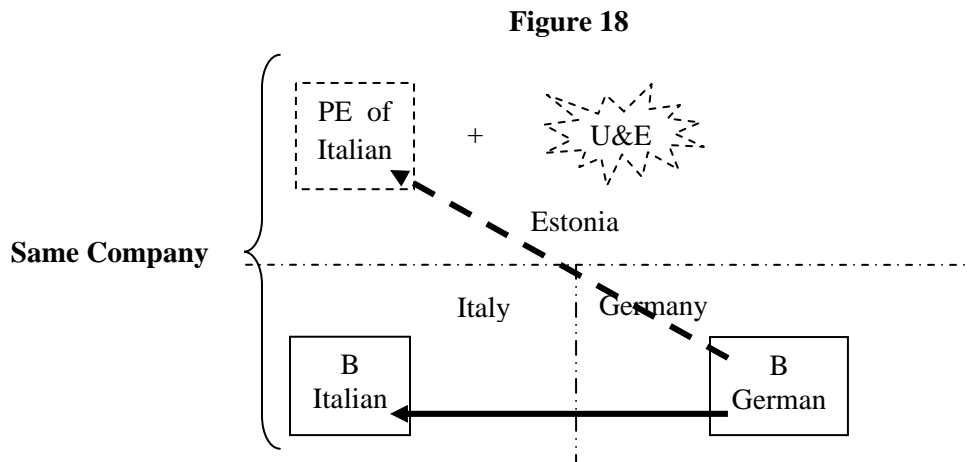


Figure 18. Assume that an Italian company (that is not registered as a taxable person in in Estonia) contracts with a German advertising firm for services in developing an advertising campaign for its products in Estonia. Assume further that these services are “received” by the PE in Estonia.

Advertising services are listed at RVD 56(1)(b). The rule for the place of supply for a service listed in RVD 56(1) between taxable persons that are “... established in the Community but not in the same country shall be the place where the customer has established his business [Italy] or has a fixed establishment for which the service is supplied [Estonia] ...”

This is a situation leads to confusion, particularly if the Italian firm [following the normal rules and RVD 56(1)] presents the German advertising company with its Italian VAT ID number, and Italian VAT is place on the invoice. Estonia would nevertheless require the PE to register as a *taxable person with limited liability* and collect Estonian VAT on these same services. Figure 18 presents this scenario.⁴⁶



CONCLUSION

Although it is a common observation that we are living in a service-intensive society, it is unfortunate that the determination of the place of supply for most services under the EU VAT is caught between proxies and non-uniform application of use and enjoyment rules.

In this article and the article which preceded it six of the twenty-seven EU countries have been considered – the Czech Republic, and the UK in the previous paper, and Germany, Austria, Denmark and Estonia in this paper. The results have ranged from near full adoption of the use and enjoyment criteria in Denmark to indirect and maybe improper adoption in Estonia.

⁴⁶ RVD 41 resolves a very similar situation for transactions in goods [where the VAT ID number used on the invoice conflicts with VAT collected in the Member State in which the intra-community transport of the goods ends]. There is no similar provision for services.

The German and Austrian approaches seemed to be the most cautious and targeted. However, as most of their rules are issued through ministerial decrees rather than statute, it is difficult to escape the impression that Germany and Austria see the use and enjoyment criterion as a corrective rather than a policy tool. PEs are critical to both the Czech Republic and Estonian applications of use and enjoyment, and a similar approach guides the UK analysis although it is embedded in the meaning of the term “belonging.”

One might have thought that use and enjoyment would have received more attention than it did in the 2008 VAT package. However, the concern there was primarily with refining the proxies, not limiting or controlling the use and enjoyment criterion. There is more work to be done.