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TAXING SERVICES UNDER THE EU VAT AND JAPANESE CONSUMPTION TAX: A COMPARATIVE ASSESSMENT OF NEW EU PLACE OF TAXATION RULES FOR SERVICES AND INTANGIBLES

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TAXING SERVICES UNDER THE EU VAT
AND JAPANESE CONSUMPTION TAX:
A COMPARATIVE ASSESSMENT OF NEW EU PLACE OF TAXATION RULES
FOR SERVICES AND INTANGIBLES

Place of taxation rules are the seminal cross-jurisdictional provisions of any consumption tax regime. They determine where among competing jurisdictions a particular service is taxed. They are not important for transactions that are restricted to a single jurisdiction and to businesses or individuals belonging to that jurisdiction. However, when two or more jurisdictions are involved, these are the essential tools for revenue allocation and avoidance of double taxation.

It is therefore of considerable importance to Japanese businesses and consumers when the European Union (EU) undertakes a wholesale revision of the place of supply rules for services and intangibles. The European Commission has advanced two sets of proposals for reform of these rules. If adopted, these changes will be comprehensive, covering business-to-business (B2B)¹ as well as business-to-consumer (B2C)² transactions, effective July 1, 2006.

OECD CONCERNS

The importance of these proposed changes is amplified by the Organization for Economic Cooperation and Development's (OECD's) recent assessment of global place of taxation rules. Examining the taxation of services and intangibles in the world's consumption tax regimes the Committee of Fiscal Affairs (CFA) concluded that these rules exhibit a general "lack of international consistency and coherence."³ According to the OECD, this lack of consistency and coherence has erected global trade barriers (double taxation), and provided opportunities for global tax avoidance.⁴

The initial CFA study led to an informal working group (IWG)⁵ under the OECD's Working Party 9 (WP9). WP9 was charged by the CFA with developing agreed

¹ Commission Proposal for a Council Directive Amending Directive 77/388/EEC as regards the place of supply of services, COM(2003) 822 final [hereinafter COM(2003) 822 final], *available at* http://europa.eu.int/eur-lex/en/com/pdf/2003/com2003_0822en01.pdf

² Amended Commission Proposal for a Council Directive Amending Directive 77/388/EEC as regards the place of supply of services, COM(2005) 334 final [hereinafter COM(2005) 334 final], *available at* http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/com/2005/com2005_0334en01.pdf

³ OECD, REPORT: THE APPLICATION OF CONSUMPTION TAXES TO THE TRADE IN INTERNATIONAL SERVICES AND INTANGIBLES 7 (June 30, 2004), *available at* <http://www.oecd.org/dataoecd/56/36/32997184.pdf>

⁴ *Id.* at 12-13. The OECD further discusses tax-caused business impact, including difficulties in accessing markets, supply chain inefficiencies, high compliance costs, non-compliance and distortion of competition.

⁵ The informal working group is comprised of Australia, Canada, the European Commission, Germany, Italy, Japan, New Zealand, Norway, Spain, and the United Kingdom. The absence of the United States from this working group is notable, particularly in light of the fact that the U.S. contains more consumption tax jurisdictions than the rest of the world combined. Admittedly, these are retail sales tax and not value added tax jurisdictions, but they are consumption tax jurisdictions nevertheless and may have valuable experiences that might add to this discussion. *Id.* at 4 n.2.

principles and guidance. In February 2005 an initial progress report and draft principles were released.⁶ It is clear from this report that there is a lot of work to be done.

Although there is general agreement that consumption should be taxed where consumption actually occurs, mature tax systems do not determine this place directly. Proxies are used almost universally. Thus, the core concern of the OECD is to develop consensus around these proxies so that the place of taxation for services and intangibles can be standardized. The OECD report states:

In general, OECD countries have set out to tax services where they are consumed. As with goods, proxies have been used to determine the place of consumption. ... Acknowledging that the use of proxies for determining consumption exists for goods and services, the Working Party sees no reason why the taxation of internationally traded services and intangibles should not also be in accordance with the rules of the jurisdiction of consumption.⁷

Because of the importance of these changes, this article first considers the proposed changes in the EU place of taxation rules for services and intangibles from the historical context of their development. It then takes up the companion rules under the Japanese Consumption Tax (CT). Less historical context is presented because these rules have a more limited history. A final section offers a comparative assessment that seeks to answer two questions. First, is there a lack of consistency and coherence between the Japanese and EU rules as currently constituted? Secondly, have the proposed changes in the EU place of taxation rules minimized or exacerbated differences?

PART I: PLACE OF TAXATION IN THE EU VAT

The proxies utilized for determining place of taxation for services and intangibles in the EU VAT are expected to undergo drastic change on July 1, 2006. They are changes of comprehensive scope, covering business-to-business (B2B)⁸ as well as business-to-consumer (B2C)⁹ transactions.

⁶ OECD: THE APPLICATION OF CONSUMPTION TAXES TO THE TRADE IN INTERNATIONAL SERVICES AND INTANGIBLES – PROGRESS REPORT AND DRAFT PRINCIPLES (Feb. 11, 2005) [hereinafter OECD, PROGRESS REPORT AND DRAFT PRINCIPLES], available at <http://www.oecd.org/dataoecd/51/32/34422650.PDF>

⁷ OECD, PROGRESS REPORT AND DRAFT PRINCIPLES, *supra*, note 4, at 6.

⁸ Commission Proposal for a Council Directive Amending Directive 77/388/EEC as regards the place of supply of services, COM(2003) 822 final [hereinafter COM(2003) 822 final], available at http://europa.eu.int/eur-lex/en/com/pdf/2003/com2003_0822en01.pdf

⁹ Amended Commission Proposal for a Council Directive Amending Directive 77/388/EEC as regards the place of supply of services, COM(2005) 334 final [hereinafter COM(2005) 334 final], available at http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/com/2005/com2005_0334en01.pdf

These developments are not a surprise. The EU has known for some time¹⁰ that the place of taxation rules for services and intangibles, which are primarily found in Article 9 of the *Sixth Directive*,¹¹ are badly in need of rethinking both to accommodate modern commercial practice, and to simply consolidate and reorganize the text itself.¹² However, the scope of these change are so comprehensive that the Commission presented them in two proposals; an initial set of changes dealing with B2B transactions was proposed on December 23, 2003, followed by B2C proposals on July 22, 2005. The second set contained some elements that modified aspects of the earlier rules.

Development of Proxies in the EU

The rules for the place of taxation of services in the EU have developed in four distinct phases marked by (a) the Second Directive, (b) the Sixth Directive, (c) the abolition of fiscal frontiers, and finally by (d) the current proposals. Throughout this development the bedrock principle of consumption taxation has remained unchanged; the place of taxation should be the place of consumption. If there is any overall trend it is in the increasing frequency with which proxies have been used to express this fundamental principle. That is, there has been a movement away from a direct utilization of the principle itself in the form of a use and enjoyment rule.

The First Phase -- 1967. The earliest VAT Directives employed principles-based, not proxy-based formulas to determine the place of taxation. Tax was imposed at the place of actual consumption, determined without recourse to proxies. Theory was directly articulated. The main rule under the Second Directive was:

¹⁰ On July 6, 2000 the European Commission presented a strategy to improve the VAT. Part of this strategy included a general review of the place of taxation of services. At that time there was a "... general consensus that the scope of taxation at the place that the customer is located (reverse charge mechanism) should be extended or made the general principle for taxation of services." [Communication from the Commission to the Council and the European Parliament, A strategy to improve the operation of the VAT system within the context of the internal market, COM(2000) 348 final at 13, *available at* http://europa.eu.int/eur-lex/en/com/cnc/2000/com2000_0348en01.pdf] The Digital VAT Directive of May 7, 2002 was a first step in this direction. However, this change was clearly temporary (set to expire on July 1, 2006), and was declared to be the last individual change in Article 9 before the more thorough and general revision of the services rules were to be undertaken. [Council Directive 2002/38/EC amending and amending temporarily Directive 77/388/EEC as regards the value added tax arrangements applicable to radio and television broadcasting services and certain electronically supplied services (May 7, 2002) O.J. (L 128) 41, *available at* http://europa.eu.int/eur-lex/en/com/cnc/2000/com2000_0348en01.pdf]

¹¹ SIXTH COUNCIL DIRECTIVE of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover tax – Common system of value added tax: uniform basis of assessment (77/388/EEC) 1977 O.J. (L 145) 1 [hereinafter SIXTH DIRECTIVE] is available at: http://europa.eu.int/eur-lex/en/consleg/pdf/1977/en_1977L0388_do_001.pdf

¹² Articles 8 and 9 of the SIXTH DIRECTIVE deal with the place of supply of goods and services in the European VAT under the heading "Place of taxable transactions." In a perfect world, one might expect that this is where all of the rules on place of taxation would be located; goods in Article 8, services in Article 9. However, the Directive on the abolition of fiscal frontiers added Article 28b under the title "Place of transactions." Article 28b deals with intra-Community transactions. [See: Council Directive 91/680/EEC supplementing the common system of value added tax and amending Directive 77/388/EEC with a view to the abolition of fiscal frontiers, (Dec. 16, 1991) O.J. (L 376) 1.] The complexity of these rules is attributable to legislative accretion. Over the years the place of taxation rules in the amended *Sixth Directive* have become a collection of more than 40 distinct rules.

The place of the provision of service shall, as a general rule, be regarded as being the place where services provided, the right transferred or granted, or the object hired, is used and enjoyed.¹³

Importantly, this rule was not that the place of taxation would be: “the place where services are provided,” or “the place where rights are transferred,” or “the place where the object is hired.” These formulations are proxy-based rules. Instead, in the Second Directive the place of taxation is simply the place where the specified service is “used and enjoyed.”

Proxies are not unheard of in the Second Directive. They are however relegated to exceptions. In fact, if a Member State decided to derogate from the main rule with respect to a particular service, proxies were expected.

Annex A of the Second Directive provides that “... each Member State may, in order to simplify the procedure for charging the tax, derogate from the provisions of Article 6(3).”¹⁴ The Proposal for the Second Directive provided an example. It suggested that publicity services might be deemed to be located, not where the services were actually used and enjoyed, but instead at the place of establishment of the customer on whose account the services were ordered. Thus, the customer’s place of establishment becomes a proxy for the place of true consumption, the place of use and enjoyment.

The Second Phase -- 1977. By the time of the Sixth Directive, ten years later, the practicalities of VAT administration necessitated that more clearly articulated rules on the place of taxation of services be drafted.¹⁵ The brief principle-centric rule from which Member States were allowed to derogate service-by-service under the Second Directive needed to be replaced with a detailed, uniform presentation of the place of taxation.

The policy choice at the time of the Sixth Directive debates was between (a) an express extension of the use and enjoyment principle to all services, followed by a list of service-specific, proxy-based exceptions or (b) the adoption of an administratively more elegant set of “dual proxies” whereby a proxy-based main rule is followed by a series of service-specific exceptions that adopt either alternate proxies or directly applied a use and enjoyment principle.

The Sixth Directive took the second approach. Article 9(1) is a proxy-based main rule,¹⁶ followed in Article 9(2) with a series of service-specific exceptions, most of which

¹³ SECOND COUNCIL DIRECTIVE of 11 April 1967 on the harmonization of legislation of Member States concerning turnover taxes – Structure and procedures for application of the common system of value added tax (67/228/EEC) O.J. (L 228) 1303 at Art. 6(3) [hereinafter SECOND DIRECTIVE].

¹⁴ *Id.* at Annex A, point 11.

¹⁵ SIXTH DIRECTIVE, *supra* note 11, Art. 37 extinguished the SECOND DIRECTIVE. It reads: “Second Council Directive 67/228/EEC of 11 April 1967 shall cease to have effect in each Member State as from the respective dates on which the provision of the Directive are brought into application.”

¹⁶ Article 9(1) is not a “main rule” in the sense that it is in any way theoretically superior to the rules in Article 9(2). Both sets of rules function through proxies, and have equal standing with each other. The ECJ explained, “... when Article 9 is interpreted, Article 9(1) in no way takes precedence over Article

are also proxies. The main rule indicates that the place of taxation should be the supplier's location. In most cases the exceptions locate the place of taxation at the buyer's location. Article 9(1) states:

The place where a service is supplied 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.¹⁷

The rules that follow under Article 9(2) target specific services.¹⁸ Thus, services connected with immovable property (real estate) are taxable where the property is located – a proxy-based rule.¹⁹ Whereas, transportation services, whether related to the transportation of goods or people, are taxed where the transportation actually takes place, a use and enjoyment standard.²⁰

9(2). In every situation, the question which arises is whether it is covered by one of the instances mentioned in Article 9(2); if not, it falls within the scope of Article 9(1).” Case 327/94, Jürgen Dudda v. Finanzgericht Bergisch Gladbach, 1996 E.C.R. I-04595 at 21, available at <http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=CELEX:61994J0327:EN:HTML>

¹⁷ SIXTH DIRECTIVE, *supra* note 11, Art. 9(1).

¹⁸ The place of taxation rules in Article 9(2) have equal stature with the rule in Article 9(1), which functions as a fall back rule in cases where a transaction does not fall within a specific Article 9(2) rule. This is the way the ECJ explained this relationship in Case C-327/94, Jürgen Dudda v Finanzamt Bergisch Gladbach, 1996 E.C.R. I-4596, 3 C.M.L.R. 1063 (1996).

It follows that, when Article 9 is interpreted, Article 9(1) in no way takes precedence over Article 9(2). In every situation, the question which arises is whether it is covered by one of the instances mentioned in Article 9(2); if not, it falls within the scope of Article 9(1).

¹⁹ SIXTH DIRECTIVE, *supra* note 11, Art. 9(2)(a). This rule appears in the legislation of each Member State. The proxy of where the real estate is located generally arrives at the correct result for services related to real estate. Nevertheless, there are difficult questions just below the surface, and in some of these instances a different proxy might more accurately arrive at the location of true consumption. For example, “... the service of consultants, engineers, consultancy bureaus, lawyers, accountants, and other similar services, as well as data processing and the supply of information, ...” are itemized in Article 9(2)(e)(third indent) of the *Sixth Directive*. This provision locates the place of taxation at the place where the customer is established. This raises the questions about the place of taxation of legal, accounting, management and other professional consulting services like architectural services when they are directly related to real estate. Which proxy should apply, the place of the real estate, or the place the customer is established?

Although the *Sixth Directive* has been in place since 1977, it was not until 1992 and 2002 that these conflicting rules were resolved in the U.K. with a *Statutory Instrument* and a *VAT Notice* respectively. Value Added Tax Rules (1992) SI 1992/3151, Art. 5(c) provides that the place of taxation for architectural services related to land is where the real estate is located. Available at <http://www.opsi.gov.uk/stat.htm>. Her Majesty's Customs and Excise, *VAT Notice* 741, at 4.6, went further in 2002. It indicated that the place of taxation for the provision of legal services (such as conveyancing or dealing with applications for planning permission) or property management services (rent collection, arranging of repairs, and maintenance of financial accounts) that were directly related to a specific site of land is where the land is located. Available at

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageImport_ShowContent&propertyType=document&columns=1&id=HMCE_CL_000346#P257_30348

²⁰ SIXTH DIRECTIVE, *supra* note 11, Art. 9(2)(b). This rule does not use a proxy. It directly references the underlying use and enjoyment principle, and requires an apportionment of transportation services among the jurisdictions where the transportation occurs based on the distance covered. Litigation has made the

Similarly, Article 9(2)(c) itemizes in four indents a set of services where use and enjoyment is deemed to occur at the place of performance.²¹ The first indent specifies that cultural, artistic, sporting, scientific, educational, and entertainment activities are taxable where the physical activity occurs. This intuitively accurate use and enjoyment standard does the best job among all the services in Article 9(2)(c) in identifying the place of consumption.²² Applying similar reasoning to ancillary transportation services

application of this rule is uniform across the EU. Case law has specified that (a) each Member State is required to tax transportation services with respect to that portion of an intra-community journey that is carried out within its territory, *Commission of the European Communities v. French Republic* (13 March 1989) [1990 ECR I-069] Case C-30/89 at 16; (b) will not allow an exemption even if the travel/ transportation is a round trip and occurs predominantly in international waters, *Commission of the European Communities v. the Hellenic Republic*, (23 May 1996) [Case C-331-94] 1996 ECR I-2675 at 15; and (c) the apportionment formula applied must uniformly be based on miles traveled within the territory as a percentage of the total miles traveled, *Reisebüro Binder GmbH v. Finanzamt Stuttgart-Körperschaften*, (6 November 1997) Case C-116/96 [1997 ECR-I6103] at 18.

²¹ SIXTH DIRECTIVE, *supra* note 11, Art. 9(2)(c). This provision states:

The place of supply of services relating to:

- cultural, artistic, sporting, scientific, educational, entertainment, or similar activities, including the activities of the organizers of such activities, and where appropriate,
- the supply of ancillary services,
- ancillary transport activities such as loading, unloading, handling and similar activities,
- valuations of movable tangible property,

shall be the place where those services are physically carried out;

²² When a taxable service comprises the application for consideration of special personal abilities, then avoiding or minimizing tax on that service is easily accomplished if the proxy rule of Article 9(1), the place where the supplier is established, defines the place of taxation. It is far too easy for suppliers of unique personal services to simply move their place of establishment (to a low-or-no-tax jurisdiction) and thereby reduce the tax burden and distort competition. Thus, for these services the proxy for the place of taxation is changed to the place of performance. It is also frequently asserted that this proxy is justifiable independent of the tax avoidance rationale as it in fact more closely aligns the services performed with the place of consumption of those services.

That being said, a further question is raised. Where is the line to be drawn around these services? How many services ancillary to the primary cultural, artistic, scientific, educational and entertainment services should also be sourced with this proxy (place of performance of the primary service) rather than the Article 9(1) proxy (seller's location)? This question approaches the heart of the multi-jurisdictional harmonization issue that concerns the OECD.

The E.C.J. considered the scope of the services under this first indent to Article 9(2)(c) and undertook a policy-level analysis of the place of taxation rules in Case C-327/94, *Jürgen Dudda v Finanzamt Bergisch Gladbach*, 1996 E.C.R. I-4596, 3 C.M.L.R. 1063 (1996). In *Dudda* acoustic, sound-engineering services provided by a one-man business, established in Germany, were used at concerts in Austria, Italy, Yugoslavia and Denmark. In determining that these services were ancillary to the services of the musicians at the concert, and they should be taxable at the place of the performance (not at Dudda's place of establishment), the ECJ determined that "no particular artistic level is required" as a precondition to an application of this proxy. Instead it is the close alignment of the secondary service (acoustical services) with the primary service (musical performance) that in turn is offered directly for final consumption that controls. This result follows directly from the overriding purpose of the *Sixth Directive*.

The Community legislature considered that, in so far as the supplier provides his services in the State in which such services are physically carried out and the organizer of the event charges the final consumer VAT in the same State, the VAT charged on the basis of those services the cost of which is included in the price of the

in the second indent results in an accurate but somewhat awkward apportionment of the VAT base measured by relative distances traveled.²³ The third and fourth indents present the most difficult proxies. The fourth suggesting that the place of performance for repair and valuation services (in State A) reasonably estimates the place of consumption for these services (when the repaired items are returned to their owner in State B).²⁴

Initially, Article 9(2)(d) established a “place of utilization” standard for the place of taxation of movable tangible property (other than means of transport).²⁵ This is the same use and enjoyment proxy that was deemed workable both for transportation services and ancillary transportation services. However, the simplicity of adopting the same rule in all three instances (movable tangible property, transportation, ancillary transportation services) was not deemed workable for very long. Article 9(2)(d) was deleted in 1984 as the Tenth Council Directive²⁶ added an eighth indent to Article 9(2)(e). Thus adopting a proxy – where the customer is located²⁷ – in place of the use and enjoyment standard.

Nothing about the scope of the rule changed. It applied to all movable tangible property except forms of transportation. By continuing the exclusion of all forms of transportation the eighth indent relegates the treatment of these services to the proxy of the general rule – the place where the supplier is located.

Intangible services comprise the final and largest category of the Article 9(2) exceptions.²⁸ Under Article 9(2)(e) the customer’s location is the proxy used. For the list

complete service paid for by the final consumer must be paid to that State and not to the State in which the supplier of the service has established his business.

²³ These are services such as loading, unloading, and handling of goods in transit. This use and enjoyment rule ties directly to the rule on transportation services. Thus, the apportionment of VAT on transportation services based on distance traveled within a Member State is reflected in a similar apportionment of VAT obligations on ancillary transportation services.

²⁴ Further complications with this rule were not fully resolved until 1995 when the Second Simplification Directive (95/7/EC) resolved a permitted ambiguity in the treatment of these supplies as either goods or services. The Directive resolved this matter in favor of services.

²⁵ Article 9(2)(d) provided:

in the case of hiring out of movable tangible property, with the exception of all forms of transport, which is exported by the lessor from one Member State with a view to its being used in another Member State, the place of supply of the service shall be the place of utilization.

²⁶ TENTH COUNSEL DIRECTIVE of 31 July 1984 on the harmonization of the laws of the Member States relating to turnover taxes, amending Dir. 77/388/EEC – Application of value added tax to the hiring of movable tangible property (84/386/EEC) 1984 O.J. (L 208) 58, available at: <http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=CELEX:31984L0386:EN:HTML>

²⁷ Prior to the addition of the eighth indent it was convenient to catalogue the services in Article 9(2)(e) as intangible services. The addition of leasing tangible personal property to Article 9(2)(e) makes this categorization less apt. This is even more the case in recent years when Article 9(2)(e) has witnessed the addition of access to gas and electricity, telecommunications, radio and television broadcasting and electronically supplied services.

²⁸ SIXTH DIRECTIVE, *supra* note 11, Art. 9(2)(e). The activities covered are specified in twelve indents, the first seven of which comprise the original “intangible services.” The current Article 9(2)(e) includes:

- transfers and assignments of copyrights, patents, licenses, trade marks, and similar rights,
- advertising services,

of services included in this provision the customer's location is determinative, unless the customer is not a taxable person and is established in the EU. In other words, this proxy applies to sales of intangible services made by EU businesses to customers located outside the EU, and to sales of intangible services to EU businesses from suppliers located in another Member State.²⁹

The precise location of Article 9(2)(e) services is not apparent from the express language of the provision. Article 9(2)(e) indicates that the place of taxation is:

... the place where the customer has established his business or has a fixed establishment to which the service is supplied, or in the absence of such place, the place where he has his permanent address or usually resides ...

What happens then, if “the place where a business has been established” differs from the place where the business has a “fixed establishment to which the service is supplied?” Does the Sixth Directive impose a priority (head office over remote fixed establishment), or does it require that the place of actual economic performance be located? Article 9(1) presents the same problem.³⁰ In parallel wording Article 9(1) states:

-
- services of consultants, engineers, consultancy bureaus, lawyers, accountants, and other similar services, as well as data processing and the supplying of information,
 - obligations to refrain from pursuing or exercising, in whole or in part, a business activity or a right referred to in this point (e),
 - banking, financial, and insurance transactions including reinsurance, with the exception of the hire of safes,
 - the supply of staff,
 - the services of agents who act in the name of and for the account of another, when they procure for their principle the services referred to in this point (e),
 - the hiring of movable tangible personal property, with the exception of all forms of transport,
 - 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,
 - telecommunications. Telecommunications services shall be deemed to be services related to the transmission, emission or reception of signals, writing, images, and sounds or information of any nature by wire, radio, optical or other electromagnetic systems, including the related transfer or assignment of the right to use capacity for such transmission, emission or reception. Telecommunications services within the meaning of this provision shall also include provision of access to global information networks.,
 - radio and television broadcasting services,
 - electronically supplied services, *inter alia*, those described in Annex L.

²⁹ SIXTH DIRECTIVE, *supra* note 11, at Preamble, seventh recital.

... whereas although the place where a supply of services is effected should in principle be defined as the place where the person supplying the services has his principle place of business, that place should be defined as being in the country of the person to whom the services are supplied, in particular in the case of certain services supplied between taxable persons where the cost of the services is included in the price of the goods; ...

It makes good sense to adopt the proxy of the customer's location when intermediate business purchases of services are incorporated into goods or services further provided to other customers. This is the operating design underpinning the place of supply rules for the services aggregated under Article 9(2)(e). *See, Dudda* 1996 E.C.R. I-4596, at 44.

³⁰ Article 9(2)(e) indicates that the place of taxation is:

... 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 place, the place where he has his permanent address or usually resides ...

The ECJ resolved this issue in *Günter Berkholz v. Finanzamt Hamburg-Mitte-Alstadt*.³¹ The ECJ determined that the place where a business is established (the head office) is the preferred proxy. It controls over a determination of where the actual economic performance occurs (a use and enjoyment standard), unless the place where a business is established "... does not lead to a rational result for tax purposes or creates a conflict with another Member State."³²

In summary: There is a strong sense in the Sixth Directive that even though the standards of Article 9(2)(e) are well considered, they are a work-in-progress more than they are a finished product. Not only have individual rules changed over time³³ but, Article 9(3) gives blanket approval for any Member State to change any of the proxy-based rules of Article 9(2)(e) if that State determines that a use and enjoyment standard is

... the place where the customer has established his business or has a fixed establishment to which the service is supplied, or in the absence of such place, the place where he has his permanent address or usually resides ...

³¹ Case C-168/84, *Günter Berkholz v. Finanzamt Hamburg-Mitte-Alstadt*, 1985 E.C.R. 2251.

³² *Id.* at 17.

³³ The place of taxation rules for services under the *Sixth Directive* are also very fungible over time. To follow these changes is to follow the efforts of the Commission as it works to refine the proxies it uses to come as close as possible (without excessive administrative complexity) to taxing services where they are consumed. For example, in the original *Sixth Directive* Article 9(2)(d) contained a special provision for the service of hiring out of movable tangible property among Member States. In all other instances, leases of movable tangible property were handled under Article 9(1) where the proxy was to deem the place of taxation to be the seller's place of business.

It soon became apparent to the Commission that not only was having two rules complex, but the main rule under Article 9(1) was producing the wrong result. This rule allowed foreign businesses to purchase EU property and then immediately leased it out without charging VAT, if they had no "establishment," "fixed establishment from which the service was supplied," "permanent address" or "usual residence" in the EU. [See: First Report from the Commission to the Council on the application of the common system of value added tax, submitted in accordance with Article 34 of the Sixth Council Directive 77/388/EEC of 17 May 1977, COM (1983) 426 final, *available at* http://europa.eu.int/prelex/detail_dossier_real.cfm?CL=en&DosId=119386#189311]

Article 9(2)(d) did not use the seller's place of business as the place of taxation, it borrowing the approach of the *Second Directive*, and used no proxy at all. It directly set down a "use and enjoyment" rule. This too was complicated, because applying it to movable property required an apportionment among Member States whenever property was moved between jurisdictions.

In the case of hiring out of movable tangible property, with the exception of all forms of transport, which is exported by the lessor from one Member State with a view to its being used in another Member State, the place of supply of the services shall be the place of utilization.

The Tenth Council Directive addressed these problems by unifying the treatment of all leases of movable tangible property, and employing a different proxy to determine the place of taxation. Article 9(2)(d) was eliminated, and a new indent was added, the eighth, under Article 9(2)(e). Thus, the proxy for determining the place of taxation for movable tangible property was moved to the customer's location.

necessary to "... avoid double taxation, non-taxation or the distortion of competition ..."³⁴

Summary of Place of Taxation Rules for Services and Intangibles

9(1)	Main rule	Proxy: supplier's location
9(2)(a)	Immovable property	Proxy: location of the real estate
9(2)(b)	Transport services	Use & Enjoyment: the place where transportation takes place
9(2)(c)		
	- Cultural, artistic, sporting, scientific, educational, entertainment or similar activities	Use & Enjoyment: place where services physically carried out
	- Ancillary transport services	Use & Enjoyment: place where services physically carried out
	- Valuations of movable tangible property	Proxy: place where services physically carried out
	- Work on movable tangible property	Proxy: place where services physically carried out
9(2)(d)	Hiring out of movable tangible property, except means of transport.	Use & Enjoyment: place of utilization
9(2)(e)	Intangible property	
	Transfers and assignments of copyrights, patents, licenses, trademarks	Proxy: customer's location
	Advertising services	Proxy: customer's location
	Consultants, engineers, consultancy bureaus, lawyers, accountants, data processing and the supplying of information	Proxy: customer's location
	Refraining from business activity	Proxy: customer's location
	Banking, financial and insurance	Proxy: customer's location
	Supply of staff	Proxy: customer's location
	Agents procuring 9(2)(e) services	Proxy: customer's location

The Third Phase -- 1991-02. In the mid-1980's the European Community undertook to complete the development of the internal market. Physical, technical and fiscal barriers to intra-community trade were to be removed. This effort entailed adjusting place of taxation rules in the Sixth Directive so that transactions in goods and

³⁴ SIXTH DIRECTIVE, *supra* note 11, Art. 9(3).

services among the Member States would be treated in the same manner as similar transactions were treated within a Member State.³⁵

During this third phase rules were also added to Article 9(2)(e) that specified the place of taxation for the transportation or transmission of natural gas and electricity,³⁶ telecommunications,³⁷ as well as radio and television broadcasting services,³⁸ and electronically supplied services.³⁹ Each of these provisions targeted two groups: supplies made to customers established outside the EU and supplies made to taxable persons within the EU, but established in a different Member State. The place of taxation in each instance is the customer's location. A separate provision, Article 9(2)(f), extends the customer's location proxy for the last of these services (electronically supplied services) to include transactions where these services are provided to non-taxable persons within the EU by taxable persons outside the EU.⁴⁰

Following a White Paper in 1985,⁴¹ wide-ranging proposals were advanced in 1987 and in 1989 for systemic changes in the Sixth Directive.⁴² The 1987 proposals included a radical simplification of the place of taxation rules.⁴³ All of the proposals were rejected. Facing a declared deadline of 1992 for the removal of fiscal barriers, the Commission put in place a transitional system in 1991. With subsequent adjustments, it is this transitional system that remains in operation today.

³⁵ "Doing away with fiscal frontiers means that inter-community sales and purchases of goods and services will be treated in the same way as those transacted within Member States." Commission Proposal for a Council Directive, completing and amending Directive 77/388/EEC, Removal of fiscal frontiers, COM(87) 322/2/Revision final, 2.

³⁶ Directive 2003/92/EC.

³⁷ Directive 1999/59/EC

³⁸ Directive 2003/38/EC.

³⁹ Directive 2003/38/EC.

⁴⁰ Directive 2003/38/EC.

⁴¹ Commission of the European Communities, Completing the Internal Market, COM(85) 310 final (June 14, 1985) 43-54

⁴² At the highest level, there are three related proposals. First is a proposal for harmonization through approximation in rates. Commission Proposal for a Council Directive completing the common system of value-added tax and amending Directive 77/388/EEC – Approximation of VAT rates, COM(87) 321 final. Second is a proposal that would allow the deduction in any Member State of input VAT paid in another Member State. Commission Proposal for a Council Directive, completing and amending Directive 77/388/EEC, Removal of fiscal frontiers, COM(87) 322/2/Revision final. Third is a proposal for a clearing-house mechanism to reallocate revenues among governments. Commission Working Document, Completing the internal market – The introduction of a VAT-clearing mechanism for intra-Community sales, COM(87) 323 final.

⁴³ The Commission proposed to drop the distinction between goods and services for transactions within the internal market. No change in the place of taxation for *goods* was contemplated, but adjustments in the place of taxation for *services* were proposed that would bring them largely into conformity with the way related goods transactions were treated. There is an embedded assumption in this declared equivalence. The assumption is that the place of departure (which is the rule for determining the place of supply for dispatched goods) is the same location where the supplier has established his business (which is the rule for determining the place of supply for most services). Specific changes were proposed for Article 9(2)(b) – making the place of taxation for transportation service the place of departure, and for Article 9(2)(e) – removing transactions between Member States from the ambit of this standard and relegating them to Article 9(1) treatment. Commission Proposal for a Council Directive, completing and amending Directive 77/388/EEC, Removal of fiscal frontiers, COM(87) 322/2/Revision final, at 3-4 (points 4 and 5), and 10.

Immediate changes were needed in place of taxation rules for services in four transportation-intensive areas.⁴⁴ The elimination of the concept of export and import among the Member States compelled these adjustments. A fifth area of concern was the place of taxation rules for intermediaries whether related to transportation services or not.

Transportation-related services. Under old rules (still applicable to transactions between Member States and third countries) transport services and ancillary services are “zero-rated” when directly linked to the external transit of goods (Article 15(13)). In addition, pursuant to Article 14(1)(i) the supply of similar services connected to the importation of goods are exempt (provided that the charge for these services is included within the taxable amount of the imported goods). Article 28b(C) and (D) set the place of taxation for these services at the place of departure of the goods, unless the customer is identified for purposes of value added tax in a member State other than that of the departure of transport. In this later instance the place of taxation is deemed to be within the jurisdiction that issued the VAT identification number.⁴⁵

The other two transportation-related changes involve the cross-border provision of repair and valuation services under the third and fourth indents of Article 9(2)(c). Because this movement of goods could no longer be considered an exempt export, followed by a zero-rated service on re-exported goods, the owner of the goods faced the prospect of a local VAT on the repair or valuation, something that would have to be reclaimed under the Eight (or Thirteenth) Directive. Article 28b(F) moves the place of taxation for these services to the territory of the Member State that issued the VAT identification number under which the services were carried out.⁴⁶

Intermediary services. With respect to intermediary services, the Sixth Directive originally determined the place of taxation under the main rule, Article (9)(1), to be where the supplier of these services had established his business or had a fixed establishment. Under Article 28b(E) three sets of rules alter this result.

First, the place of taxation for intermediaries participating in the supply of intra-community transportation of goods is the place of departure.⁴⁷ Second, intermediaries participating in the supply of services ancillary to the intra-community transportation of

⁴⁴ There was no change made in the general rule of Article 9(1), nor in the rule for services connected to immovable property of Article 9(2)(a), nor in the rule for cultural, artistic, sporting, scientific, educational, entertainment or similar activities of Article 9(2)(c) first indent, nor in the rules under Article 9(2)(e) related to intangible services.

⁴⁵ The second Simplification Directive 95/7/EC expanded the definition of “intra-community transport of goods” in Article 28b(C)(1) first indent to include “head and tail transport,” domestic transportation services that are directly linked to the arrival or departure of intra-community transported goods.

⁴⁶ This change was added by the second Simplification Directive 95/7/EC. There is a difference in the treatment of repair services as opposed to valuation services. Article 28a(5)(b) fifth indent further requires repaired goods to be returned to the “person who dispatched them” in order to be excluded from treatment as an intra-community supply. For valuation services however, Article 28b(F) only requires that the goods be “dispatched or transported out of the Member State” where the services were physically carried out to be excluded from intra-community supply treatment.

⁴⁷ Article 28b(E)(1).

goods have the place of taxation determined at the place where the services are physically performed.⁴⁸ Third, the place of taxation for all other intermediary services is also the place where the services are physically performed.⁴⁹ In each of these cases however, if the customer for whom the services are provided is identified for value added tax purposes in a different Member State, then the place of taxation for these intermediary services are deemed to be the Member State of identification.⁵⁰

The Fourth Phase – 2003-06. In July 2000 the European Commission presented its strategic vision on how to improve the operation of the VAT.⁵¹ Minor revisions were deemed necessary in the place of taxation for goods,⁵² but significant changes were thought necessary for services.⁵³ The E-Commerce VAT Directive⁵⁴ that soon followed was declared to be the last individual change to Article 9 before the general revision.

The comprehensive redesign of Article 9 proceeded in two phases. The first set of proposals concerned supplies among taxable persons (B2B transactions). The proposals were issued on December 23, 2003.⁵⁵ The second set of proposals concentrated on supplies made to non-taxable customers (B2C transactions) and was released on July 22, 2005.⁵⁶ On October 17, 2005 the Council adopted regulations based on these proposals with an effective date of July 1, 2006.

As a conceptual matter the new rules depart significantly from what came before in two ways. First, the rules are relational rather than transactional in design. That is, rather than conceiving of a single main rule followed by exceptions crafted around types of transactions, the structure of the new Article 9 revolves around two main rules, one for B2B the other for B2C transactions. The exceptions that fall under each transaction type are discretely stated, maintaining the initial B2B/ B2C division. Secondly, the premise that intra-community supplies should adhere to different place of taxation rules than do extra-communities supplies is abandoned. Thus, Articles 28b(C), (D), (E) and (F) are deleted. A third characteristic of the new rules is that they more heavily rely on proxies than do the place of taxation rules in any of the earlier three developmental phases.

B2B transactions. The main rule for the place of taxation of services in B2B transactions is a proxy – the customer’s place of establishment.⁵⁷ The reverse charge mechanism is extended to all transactions covered by the main rule.⁵⁸

⁴⁸ Article 28b(E)(2).

⁴⁹ Article 28b(E)(3).

⁵⁰ Article 28b(E)(1), (2) and (3).

⁵¹ COM(2000) 348 final, 7 July 2000 “A strategy to improve the operation of the VAT system within the context of the internal market.”

⁵² *Id.*, at 11-12. The three areas of concern were (1) supplies where the supplier is responsible for assembly and installation on the customer’s premises, (2) sales of goods through distribution networks, and (3) distance selling.

⁵³ *Id.*, at 13.

⁵⁴ Directive 2002/38/EC adopted 7 May 2002.

⁵⁵ COM(2003) 822 final, *supra* note 8.

⁵⁶ COM(2005) 334 final, *supra* note 9.

⁵⁷ (New) Article 9(1). The provisions under current law (Articles 28b(C), (D), (E) and (F)) that deem the place of supply to be the Member State where the customer is registered for VAT purposes are eliminated.

Administrative and policy reasons necessitate four exceptions to the main B2B place of taxation rule. The exceptions are familiar ones and relate to (1) immovable property,⁵⁹ (2) passenger transportation,⁶⁰ (3) cultural, artistic, sporting and entertainment activities,⁶¹ and (4) “tangible services.” There is an elegant simplicity in being able to describe the B2B rules in three or four short sentences. The same will not be true in the B2C context.

Aside from the omission of scientific and educational services from the third exception (thereby placing these services under the main rule), the only major issue concerns the “tangible services” concept. Defined to be a limited class of services like restaurant meals and haircuts, these are the only B2B services where the place of taxation is the supplier’s place of establishment.⁶²

B2C transactions. The place of taxation rules for services in B2C transactions are controlled by two considerations: (1) the absence of a workable reverse charge mechanism in the VAT for non-taxpayers, and (2) the disruption that would be caused if some (but not all) comparable B2C/ B2B transactions were treated differently. The first consideration determines the main rule; the second (in conjunction with consumption tax theory, and enforcement concerns) determines the design of the exceptions.

The main rule for the place of taxation of services in B2C transactions is a proxy – the supplier’s place of establishment.⁶³ This is the opposite of the proxy used by the main rule in B2B transactions – the customer’s location.⁶⁴

⁵⁸ Currently Article 21(1)(b) applies the reverse charge mechanism when a taxable person acquires a service listed in the current Article 9(2)(e). This provision will be extended to cover all (new) Article 9(1) services.

⁵⁹ (New) Article 9a is nearly identical to (old) Article 9(2)(a). Services related to immovable property are taxable where the property is located. The only significant change is the specific reference to “the provision of hotel or similar accommodation” within the standard.

⁶⁰ (Old) Article 9(2)(b) taxes passenger transportation in proportion to the distances traveled, and the same rule is applied in (new) Article 9b. The same rule is needed in B2B and B2C transactions. The only realistic alternative to the distances traveled measure was thought to be the proxy standard of the place of departure. This rule was rejected because it was feared that it would open opportunities for tax avoidance through the relocation of transport service providers as an underlying problem in this area are the levels of the rates and the exemptions applied among the Member States in this sector of the economy. COM(2005) 334 final, at 9.

⁶¹ (New) Article 9c is nearly identical to (Old) Article 9(2)(c). Both determine the place of taxation as the place where these services are performed.

⁶² (New) Article 9d(1). A tangible service is defined as a service that meets the following three tests: (1) the service is rendered in the Member State where the supplier is established, (2) the nature of the service requires the physical (or material) presence of the supplier and the customer, and (3) the services are provided directly to an individual for immediate consumption. The two examples provided are a haircut and a restaurant or catered meal. Expressly excluded from this definition are the services of providing long-term leases and work performed on movable tangible property.

⁶³ (New) Article 9(2).

⁶⁴ (New) Article 9(1).

There are a number of instances where similar B2B and B2C transactions will reach different results based on an application of main rules. These differences are not specified in the proposals. They occur “behind the scenes” in a sense and are not deemed to be overly disruptive to the system. The most notable examples arise when the services listed under (Old) Article 9(2)(e) are considered, not as (New) Article 9i considers them – as transactions involving non-taxable persons outside the Community – but as purely intra-community transactions.⁶⁵ The Commission acknowledges the complexity that results from this application.⁶⁶

There are eleven exceptions to the uniform application of the main rule for B2C transactions. Six of these provide for harmonized B2B and B2C treatment; the other five are instances where the main rule is applied in B2B transactions in tandem with a different rule (other than the main rule) for a B2C transaction.

The six harmonized rules relate to services for (1) immovable property,⁶⁷ (2) passenger transportation,⁶⁸ (3) restaurant and catering services provided on board ships, trains, airlines and other means of transportation,⁶⁹ (4) long-term leases of means of transport,⁷⁰ (5) distance services, including television and radio broadcasting, telecommunications, electronically supplied services and distance teaching without physical presence,⁷¹ and (6) services to customers outside the EU.⁷²

⁶⁵ Thus, when the following services are provided the place of taxation will either be the customer’s location (B2B) or the supplier’s location (B2C) depending entirely on whether the customer is a taxable or non-taxable person: the transfers and assignments of copyrights, patents, licenses, trade marks; advertising services; the services of consultants, engineers, consultancy firms, lawyers, accountants and other similar services, as well as data processing and the provision of information; obligations to refrain from pursuing business activity; banking, financial and insurance transactions; the supply of staff; the hiring out of movable tangible property with the exception of means of transport; the provision of access to, and the transport or transmission through, natural gas and electricity distribution systems.

⁶⁶ The solution offered for this complexity is the October 2004 proposal for (New) Article 22b. That proposal was for a one-stop shop for EU businesses, allowing all VAT reporting obligations to be met through the filing of a single electronic return in a jurisdiction of choice. If adopted the Article 22b one-stop shop would function similar to the one-stop shop that is currently available to non-EU businesses under Article 26c. COM(2004) 728 final. Available at:

http://europa.eu.int/comm/taxation_customs/publications/official_doc/COM_728_en.pdf

⁶⁷ (New) Article 9a applies to B2B and B2C transactions and determines that the place of taxation for services provided for immovable property is where the property is located.

⁶⁸ (New) Article 9b applies to B2B and B2C transactions and determines that the place of taxation for passenger transport services is where the transport takes place in proportion to the distances covered.

⁶⁹ (New) Article 9f(2) for B2C transactions, and (New) Article 9d(2) for B2B transactions determine the place of taxation for restaurant and catering services provided on board ships, trains, airlines and other means of transport to be at the place of departure of the transport services.

⁷⁰ (New) Article 9(1) for B2B and (New) Article 9f(3) first paragraph for B2C transactions determine the place of taxation to be at the supplier’s location.

⁷¹ (New) Article 9g(1)(a), (b), (c) and (d) adopt the customer’s location for the place of taxation to bring these rules into conformity with the main rule under (New) Article 9(1) which determines (under the main rule for B2B transactions) that the place of taxation is similarly the customer’s location.

⁷² (New) Article 9i(a), (b), (c), (d) (e), (f), (g), and (h) contains the familiar list of services under (Old) Article 9(2)(e). It adopts the customer’s location for the place of taxation when the service provider is within the EU, and the customer is outside of the EU. It includes the transfers and assignments of copyrights, patents, licenses, trade marks; advertising services; the services of consultants, engineers, consultancy firms, lawyers, accountants and other similar services, as well as data processing and the

In the remaining five rules the place of taxation for a B2B transaction follows the main rule – the customer’s location, but the corresponding B2C rule follows either a use and enjoyment standard (three instances) or a rule designed to minimize tax avoidance opportunities (two instances).

For B2C restaurant and catering services,⁷³ the short term hiring of transport,⁷⁴ and the services associated with exhibitions, fairs, the valuation of and work on movable tangible property⁷⁵ a use and enjoyment standard is applied. Similar B2B transactions would be taxed under the main rule – at the customer’s location.

For the B2C service of transporting goods and the services of intermediaries the Commission was concerned with tax avoidance and the disruption of competition. Thus, even though in both instances the place of taxation for similar B2B transactions is determined by the main rule – the customer’s location, the rule for B2C transactions is different. In both instances the B2C rules adopted were well tested. They were carried over from deleted provisions under the “Transitional Arrangements for the Taxation of Trade between Member States.”⁷⁶ Thus, the place of taxation for B2C transport of goods is the place of departure of the goods,⁷⁷ and the place of taxation for the B2C services of intermediaries is the place where the principle transaction is carried out.⁷⁸

provision of information; obligations to refrain from pursuing business activity; banking, financial and insurance transactions; the supply of staff; the hiring out of movable tangible property with the exception of means of transport; the provision of access to, and the transport or transmission through, natural gas and electricity distribution systems. Thus bringing this rule into conformity with the main rule under (New) Article 9(1) that controls the place of taxation for similar B2B transactions.

⁷³ (New) Article 9f(1)(d) determines the place of taxation for B2C restaurant and catering services to be at the place where they are physically carried out, even though the same services provided for a taxable person would be taxed under the general rule at the customer’s location (Article 9(1)).

⁷⁴ (New) Article 9f(3) in the second paragraph determines that the place of taxation for a B2C short-term lease of movable tangible property is the place where the customer takes physical possession, even though the same short-term lease of movable tangible property entered into by a taxable person would be taxed at the customer’s location under the general rule of Article 9(1).

⁷⁵ (New) Article 9f(1)(b) carries over the rule of (Old) Article 9(2)(c) in the third and fourth indents, and determines the place of taxation for exhibitions, fairs, the valuation of and work on movable tangible property at the place where the physical service is carried out. In contrast, for a B2B transaction the place of taxation would be the customer’s location under the general rule of Article 9(1).

⁷⁶ Title XVIa of the SIXTH DIRECTIVE INTRODUCED BY Directives 91/680/EEC and 92/111/EEC.

⁷⁷ (New) Article 9e(1), and formerly the rule for the intra-community transport of goods under (Old) Article 28b(C)(2).

⁷⁸ (New) Article 9h, and formerly the rule for the intra-community transport of goods under (Old) Article 28b(E)(3).

Summary:
Place of Taxation for Services & Intangibles – Current Rules v. Proposed Rules

CURRENT RULES			PROPOSED RULES		
MAIN RULES					
9(1)	Main Rule	B2B & B2C - (Proxy): Supplier's location	9(1)	B2B Main Rule	B2B - (Proxy): Customer's location
			9(2)	B2C Main Rule	B2C - (Proxy): Supplier's location
IMMOVABLE PROPERTY (REAL ESTATE)					
9(2)(a)	Immovable Property	B2B & B2C - (Proxy): location of the property	9a	Immovable Property	B2B & B2C - (Proxy): Location of the property
TRANSPORT SERVICES					
9(2)(b)	Transport services	B2B & B2C - Use & Enjoyment: where transport takes place.	9b	Transport services (people only)	B2B & B2C - Use & Enjoyment: where transport takes place.
28b(C)(2)	Intra-community (goods only)	B2B & B2C - (Proxy): Place of departure	Deleted		
28b(C)(2) and (3)	Intra-community (goods only)	B2B (only) - (Proxy): Jurisdiction of VAT ID	Deleted		
			9(e)(1)	Transport services (goods only)	B2C - (Proxy): Place of departure
			9(1)	Transport services (goods only)	B2B - (Proxy): Customer's location
14(1)(i)	Transportation of Imported goods	Exempt if price included in cost of goods.			
15(13)	Transportation of Exported goods	Zero-rated if directly linked to export.			
CULTURAL, ARTISTIC ETC.					
9(2)(c) 1 st indent	Cultural, artistic, scientific, educational, entertainment	B2B & B2C - Use & Enjoyment: Place where the service is physically carried out.	9c	Cultural, artistic, entertainment activities	B2B & B2C - Use & Enjoyment: Place where service is physically carried out.
			9f(1)(c)	Scientific & Educational [Except: Teaching without physical presence]	B2C : Use & Enjoyment: Place where the service is physically carried out.
			9g(1)(d)	Teaching without physical presence.	B2C - (Proxy): Customer's location.
			9(1)	Scientific & Educational	B2B - (Proxy): Proxy: Customer's location

ANCILLARY TRANSPORT SERVICES					
9(2)(c) 2 nd indent	Ancillary transport services	B2B & B2C - Use & Enjoyment: Place where physically carried out.	9f(1)(a)	Ancillary transport services	B2C : Use & Enjoyment: Place where physically carried out.
28b(D)	Intra-community	B2B (only) - (Proxy): Jurisdiction of VAT ID	Deleted		
			9(1)		B2B - (Proxy): Proxy: Customer's location
9(2)(c) 3 rd indent	Valuation of movable TPP	B2B & B2C - Use & Enjoyment: Place where physically carried out.	9f(1)(b)	Valuation of movable TPP	B2C : Use & Enjoyment: Place where physically carried out.
			9(1)		B2B - (Proxy): Proxy: Customer's location
9(2)(c) 4 th indent	Work on movable TPP	B2B & B2C - Use & Enjoyment: Place where physically carried out.	9f(1)(b)	Work on movable TPP	B2C : Use & Enjoyment: Place where physically carried out.
			9(1)		B2B : Proxy: Customer's location
INTANGIBLE PROPERTY – COPYRIGHTS ETC.					
9(1) 9(2)(e) 1 st indent	Copyrights, Patents, Licenses, Trade marks.	B2C (generally) - (Proxy): Supplier's location B2C (Outside EU) & B2B - (Proxy): Customer's location	9(2) 9i(a) 9(1)	Copyrights, Patents, Licenses, Trade marks.	B2C (generally) - (Proxy): Supplier's location B2C (Outside EU) & B2B - (Proxy): Customer's location
INTANGIBLE PROPERTY – ADVERTISING					
9(1) 9(2)(e) 2 nd indent	Advertising services	B2C (generally) - (Proxy): Supplier's location B2C (Outside EU) & B2B - (Proxy): Customer's location	9(2) 9i(b) 9(1)	Advertising services	B2C (generally) - (Proxy): Supplier's location B2C (Outside EU) & B2B - (Proxy): Customer's location
INTANGIBLE PROPERTY – PROFESSIONAL SERVICES					
9(1) 9(2)(e) 3 rd indent	Consultants, engineers, consultancy bureaus, lawyers, accountants, data processing and the supplying of information	B2C (generally) - (Proxy): Supplier's location B2C (Outside EU) & B2B - (Proxy): Customer's location	9i(c) 9(1) 9d(1)	Consultants, engineers, consultancy bureaus, lawyers, accountants, data processing and the supplying of information	B2C (generally) - (Proxy): Supplier's location B2C (Outside EU) & B2B - (Proxy): Customer's location
INTANGIBLE PROPERTY – REFRAIN FROM BUSINESS					
9(1) 9(2)(e) 4 th indent	Refrain from business activity	B2C (generally) - (Proxy): Supplier's location B2C (Outside EU) & B2B - (Proxy): Customer's location	9(2) 9i(d) 9(1) 9d(1)	Refrain from business activity	B2C (generally) - (Proxy): Supplier's location B2C (Outside EU) & B2B - (Proxy): Customer's location
INTANGIBLE PROPERTY – BANKING, FINANCIAL ETC.					
9(1) 9(2)(e) 5 th indent	Banking, financial and insurance transactions (not safes)	B2C (generally) - (Proxy): Supplier's location B2C (Outside EU) & B2B - (Proxy): Customer's location	9(2) 9i(e) 9(1) 9d(1)	Banking, financial and insurance transactions (not safes)	B2C (generally) - (Proxy): Supplier's location B2C (Outside EU) & B2B - (Proxy): Customer's location

INTANGIBLE PROPERTY – INTERMEDIARIES					
9(1)	Intermediary services	B2B & B2C - (Proxy): Supplier's location	9(2) 9h 9(1)	Intermediary services	B2C - (Proxy): Location of principal transaction B2B - (Proxy): Customer's location
9(1) 9(2)(e) 6 th indent	Services of agents when procuring 9(2)(e) services	B2C (Outside EU) & B2B - (Proxy): Customer's location			
28b(E)(1)	Intra-community Intermediary services (transport of goods services, ancillary to transport of goods services, others)	B2C - (Proxy): Place of departure. B2B - (Proxy): Deemed to be VAT ID # location of principal.	Deleted		
28b(E)(2)	Intra-community Intermediary services (ancillary to transport of goods services }	B2C - (Proxy): Place of performance. B2B - (Proxy): Deemed to be VAT ID # location of principal.	Deleted		
28b(E)(3)	Intra-community Intermediary services (other)	B2C - (Proxy): Place where primary transaction is carried out. B2B - (Proxy): Deemed to be VAT ID # location of principal.	Deleted		
INTANGIBLE PROPERTY – HIRING OUT MOVABLE TPP (INCLUDING TRANSPORT)					
9(1) 9(2)(e) 7 th indent	Hiring out of movable TPP (not means of transport)	B2C (generally) - (Proxy): Supplier's location B2C (Outside EU) & B2B - (Proxy): Customer's location	9i(f) 9(2) 9(1)	Hiring out of movable TPP (not means of transport)	B2C (generally) - (Proxy): Supplier's location B2C (Outside EU) & B2B - (Proxy): Customer's location
9(1)	Hiring out of means of transport (only)	<u>ARO Lease</u> ; 9(1) Proxy: Supplier's location	9(d)(1) 9(1)	Hiring out of means of transport.	B2B – ST Lease - (Proxy): Supplier's location B2B – LT Lease - (Proxy): Customer's location
			9(2) 9f(3)(2 ⁿ d para.) 9f(3)(1 ^s t para.)	Hiring out of means of transport.	B2C – ST Lease - (Proxy): At place of transfer of possession B2C – LT Lease - (Proxy): Customer's location
9(2)(e) 8 th indent	Access to/ transport of natural gas & electricity	B2C (Outside EU) B2B: Proxy: Customer's location	9i(h) 9(2) 9(1)	Access to/ transport of natural gas & electricity	B2C (generally) - (Proxy): Supplier's location B2C (Outside EU) & B2B - (Proxy): Customer's location
DISTANCE SUPPLIES (TELECOM. RADIO & TELEVISION; ELECTRONICALLY SUPPLIED SERVICES):					
9(2)(e) 8 th indent 9(1)	Tele-communications	B2C (generally) - (Proxy): Supplier's location B2C (Outside EU) & B2B - (Proxy): Customer's location	9g(1)(b) 9(1)	Tele-communications	B2C (Distance sales) : (Proxy): Customer's location B2B - (Proxy): Customer's location

9(2)(e) 9 th indent 9(1)	Radio & Television	B2C (generally) - (Proxy): Supplier's location B2C (Outside EU) & B2B - (Proxy): Customer's location	9g(1)(c)	Radio & Television	B2C (Distance sales): (Proxy): Customer's location B2B - (Proxy): Customer's location
9(2)(e) 10 th indent	Electronically supplied services	B2C (generally) - (Proxy): Supplier's location B2C (Outside EU) & B2B - (Proxy): Customer's location	9g(1)(a) 9(1)	Electronically supplied services	B2C (Distance sales): (Proxy): Customer's location B2B - (Proxy): Customer's location
9(2)(f)		B (Outside EU) 2 C (inside EU) – (Proxy): Customer's location			
			9g(1)(d) 9(1)	Teaching without physical presence	B2C & B2B (Proxy) - Customer's location
RESTAURANT/ CATERING SUPPLIES					
9(1)	Restaurant/ catering	Proxy: Supplier's location	9f(1)(d) 9d(1)	Restaurant/ catering	B2C: Use & Enjoyment: where physically carried out. B2B - (Proxy): Supplier's location
<u>Faaborg- Gelting Linien</u>	Restaurant/ catering on ship, train & boat.	Proxy: Supplier's location	9f(2) 9d(2)	Restaurant/ catering on ship, train & boat.	B2C & B2B: Proxy: Place of departure

PART II: PLACE OF TAXATION IN THE JAPANESE CONSUMPTION TAX

Introduction. Unlike the EU VAT, the Japanese Consumption Tax⁷⁹ is not a transactional tax. It does not rely on invoices to verify taxable sales and deductible purchases. Additionally, there is no requirement that the amount of tax be shown separately on an invoice.⁸⁰ It is nevertheless, a destination-based tax that exempts (or “zero-rates”) exports.⁸¹ The shorthand expression commonly used to describe the tax is a

⁷⁹ JAPAN'S REVISED CONSUMPTION TAX LAW (SHOUHIZEIHOU), LAW NO. 108, 1988, AND APPENDIXES by approving the changes contained in LAW NO. 49, 2000; CABINET ORDER (SHOUHIZEIHOU SEKOUKEI) NO. 360, 1988 (most recent amendment, ORDER NO. 147, 2000 available at: <http://www>. (in Japanese). For an English translation of the Consumption Tax law based on Law No. 108, 1988 by approving changes contained in Law No. 49, 2000 see “Consumption Tax Law,” tr. Vickie L. Beyer, 2000 WTD 247-20 (December 22, 2000). For a translation of the appendixes to Japan's revised consumption tax law, Law No. 108 see “Translation of Exemptions to Japan's Revised Consumption Tax Law,” tr. Vickie L. Beyer, 2000 WTD 247-21 (December 22, 2000). For a translation of the final regulations, Cabinet Order No. 360, 1988 (most recent amendment, Order No. 147, 2000) see “An Order for the Enforcement of the Consumption Tax Law,” tr. Vickie L. Beyer, 2001 WTD 36-24 (February 20, 2001).

⁸⁰ Alan Schenk, “Japanese Consumption Tax After Six Years: A Unique VAT Matures,” 11 TAX NOTES INT'L 1379 (Nov. 20, 1995) at 1380.

⁸¹ JAPAN CONSUMPTION TAX, *supra* note 79, at Articles 7 and 30(1).

“credit subtraction VAT without invoices.”⁸² Its uniqueness is in the mechanics of its operation, not in its tax results.

This study is concerned with the interrelationship of the Japanese Consumption Tax and the EU VAT; how services and intangibles that are exported and imported in Japan-EU trade are treated. If the mutual operation of the Japanese-EU consumption tax results in either double taxation or non-taxation, then the February 2005 concerns of the OECD may be well founded, and an adjustment may be in order on either the Japanese or the EU side.

Summary of the Japanese CT place of taxation rules. The place of taxation for services is set out Articles 6-2-1 through 6-2-7 of Cabinet Order No. 360, 1988. These seven sections roughly divide into two groups of three rules followed by a catchall seventh section. The rules within each group are very similar.

The first three rules deal with the (1) “the carriage or communication of goods or travelers,” (2) “communications” more generally, and (3) “postal items.” In each instance the Cabinet Order sets out dual place of taxation rules.⁸³ The Cabinet Order designates the place of taxation to be, respectively: (1) “the place of arrival or the place of dispatch or departure of said goods or travelers;” (2) “the place of dispatch or receipt” of communications; and (3) “the place of dispatch or receipt” of postal items.

The second set of rules deals with the provision of (1) “insurance,” (2) “information or design” services, and (3) “the provision of services involving tests, supervision, consultations, proposals, plans and surveys which require specialized scientific and technical knowledge in relation to the construction or manufacture of items ... (Production Facilities).” In each of these instances the Cabinet Order looks to the office most directly involved in the performance of the service to determine the place of taxation; the supplier’s office in two instances and the customer’s office in the third.⁸⁴ The Cabinet Order determines that the place of taxation for these services is respectively, the location of: (1) “the office concerned in concluding a contract for insurance;” (2) “the office concerned in the provision of information and designs, of the person effecting the provision” of the service; and (3) “the place to which the greater part of the materials required for the construction or manufacture of said Production Facilities.”

The catchall rule in Article 6-2-7 follows the rules of the second group. It indicates that the place of taxation for all services “other than those mentioned in the

⁸² ALAN Schenk & OLIVER Oldman, *VALUE ADDED TAX: A COMPARATIVE APPROACH IN THEORY AND PRACTICE* 38 Transnational Publishers 2001.

⁸³ The Cabinet Order appears to overreach by assigning dual place of taxation rules in these sections, but in practice it is only the import related rules that have any real significance, because all export related services are exempt. *JAPAN CONSUMPTION TAX*, *supra* note 79, at Article 7-1-3.

⁸⁴ In EU terminology these are “fixed establishment” tests. The first two rules echo Article 9(1)’s “... the place where the supplier has established his business or has a fixed establishment from which the service is supplied ...” and the third rule echoing Article 9(2)(e)’s “... the place where the customer has established his business or has a fixed establishment to which the service is supplied ...”

previous items ... [is] the location of the office of the person providing the service which is concerned in providing the service.”

ANALYTICAL DESCRIPTION

The Japanese Consumption Tax is imposed on the sale and lease of assets and on services rendered for consideration in Japan, as well as on imports.⁸⁵ The tax base starts with taxable sales made by each vendor or supplier.⁸⁶ Taxable businesses must account separately for taxable sales, and the amount of tax levied.⁸⁷ A deduction is allowed for the consumption tax applicable to qualified purchases of goods and services, that is for goods or services that are incorporated into the products or services that are eventually sold.⁸⁸

The relevant operating provisions of the Consumption Tax can be explained through four examples. The initial example demonstrates a basic, domestic-only transaction. The next example considers the treatment of Japanese exports (both goods and services), followed by two examples that consider the importation of goods and finally the importation of services.

1. Basic Domestic Tax Calculation Under the Consumption Tax

Assume that Japan Co. needs a new corporate headquarters in Tokyo. It hires a famous Japanese architect to design the building for 100. The architect, a Japanese business, imposes Consumption Tax on the services rendered. All work is done in the Tokyo offices of the architect. The other tax attributes of Japan Co. include taxable sales of 1,000 and deductible purchases of 600. The current tax rate is 5%.

- a. Cost of architectural services = 100 + CT paid of 5
- b. Other financial information for Japan Co.
 - i. Taxable sales 1,000 + CT collected of 50
 - ii. Taxable purchases 600 + CT paid of 30
- c. Calculation of CT return:
 - i. Total CT collected on taxable sales = $1,050 \times 5/105 = 50$
 - ii. Total CT due on deductible purchases = $735 \times 5/105 = 35$
 - iii. Net CT payable = 15
- d. Calculation of profit for Japan Co.:
 - i. Sales = 1,050
 - ii. Less:
 1. Purchases = 735
 2. CT = 15
 - iii. Profit = 300

The tax is determined in three steps at item “c” above. First, the tax on sales is determined by multiplying the aggregate receipts from taxable sales plus consumption tax collected times a fraction. The fraction is tax rate divided by 100 plus the tax rate

⁸⁵ JAPAN CONSUMPTION TAX, *supra* note 79, at Articles 28-30.

⁸⁶ JAPAN CONSUMPTION TAX, *supra* note 79, at Articles 5 and 42.

⁸⁷ JAPAN CONSUMPTION TAX, *supra* note 79, at Article 45(1).

⁸⁸ JAPAN CONSUMPTION TAX, *supra* note 79, at Article 45(1).

(5/105). Thus, the Consumption Tax on sales of 1,050 is 50. Second, the deductible tax amount is determined in the same manner. In this case the total of creditable purchases is the sum of the architect's services and other taxable purchases, plus related consumption taxes paid ($100 + 600 + 5 + 30 = 735$). This amount, 735, multiplied by 5/105, yields a deduction of 35. The Consumption Tax return will then net the 50 collected with 35 paid to determine the tax due of 15. The after-consumption tax profit of Japan Co. is 300.

No difference would arise if Japan Co. had purchased taxable goods for 100 from a domestic supplier instead of purchasing taxable architectural services from a domestic supplier. Both goods and services are taxable under the Japanese Consumption Tax.

2. Cross-Border (Export) Treatment Under the Consumption Tax

Japan Co.'s consumption tax liability would change however, if 200 of the 1,000 in taxable sales had been exported instead of sold domestically. Export sales are free of tax.⁸⁹ Importantly, the operation of this export exemption would not produce a change in Japan Co.'s after-consumption tax profits.

The treatment of exports can be demonstrated by adjusting the previous example as follows – 200 is removed from the taxable sales amount on line b(i), and a new line is added at b(ii) to record the 200 in export sales. The related Consumption Tax amounts will be 40 (on line b(i)) and 0 (on line b(ii)).

Importantly, when calculating the tax deduction, Japan Co. is allowed to fully deduct the Consumption Tax paid on purchases, even those related to exports. The calculation of the tax is presented below.

- a. Cost of architectural services = 100 + CT paid of 5
- b. Other financial information for Japan Co.
 - i. Taxable sales 800 + CT collected of 40
 - ii. Non-taxable export sales 200 + CT collected of 0
 - iii. Taxable purchases 600 + CT paid of 30
- c. Calculation of CT return:
 - i. Total CT collected on taxable sales = $840 \times 5/105 = 40$
 - ii. Total CT due on deductible purchases = $735 \times 5/105 = 35$
 - iii. Net CT payable = 5
- d. Calculation of profit for Japan Co.:
 - i. Sales = 1040
 - ii. Less:
 1. Purchases = 735
 2. CT = 5
 - iii. Profit = 300

Japan Co.'s tax liability falls from 15 to 5 in this example because the tax is removed from the 200 in export sales ($200 \times 5\% = 10$). The Consumption Tax is neutral with respect to exports. Profits remain the same for Japan Co. whether it sells its output domestically or overseas. Additionally, there would be no difference in treatment if

⁸⁹ JAPAN CONSUMPTION TAX, *supra* note 79, at Article 7.

Japan Co. had exported 200 in services instead of 200 in goods. Japan's Consumption Tax treats all exports the same.⁹⁰

The cross-border treatment of imports is more complex than the treatment of exports. The final two examples consider the importation of goods and then services.

3. Cross-Border (Import) Treatment of Goods Under the Consumption Tax

Using the same basic example, assume that instead of purchasing architectural services Japan Co. imports foreign goods for 100. The imported goods will be used along with the other taxable purchases to produce Japan Co.'s taxable goods or services. A tax will be imposed on the imported goods when they are removal from the bonded warehouse.⁹¹

Under these facts Japan Co.'s Consumption Tax liability remains unchanged from the first example where all taxable purchases were from domestic sources. Once again, there is no impact on Japan Co.'s corporate profits. The Consumption Tax is neutral. It neither encourages nor discourages choices among domestic or foreign purchases of goods for business inputs. The calculation of the tax is presented below.

- a. Cost of imported foreign goods = 100 + CT paid of 5
- b. Other financial information for Japan Co.
 - i. Taxable sales 1,000 + CT collected of 50
 - ii. Taxable purchases 600 + CT paid of 30
- c. Calculation of CT return:
 - i. Total CT collected on taxable sales = $1050 \times 5/105 = 50$
 - ii. Total CT due on deductible purchases = $735 \times 5/105 = 35$
 - iii. Net CT payable = 15
- d. Calculation of profit for Japan Co.:
 - i. Sales = 1050
 - ii. Less:
 1. Purchases = 735
 2. CT = 15
 - iii. Profit = 300

4. Cross-Border (Import) Treatment of Services Under the Consumption Tax

Assume the same facts as in the first example, except that Japan Co. decides to hire the services of a famous French architect to design its new Tokyo building for 100. A third party (not related to the architect) does all the necessary site inspections and preparations (measurements, soil tests etc.) in Japan. The French architect never visits Japan. All work is done in the architect's offices in Paris. All documentation is presented to Japan Co. in Paris.

⁹⁰ JAPAN CONSUMPTION TAX, *supra* note 79, at Article 2-8 (defining the transfer of assets to include the "provision of services as a business for compensation") and Article 7-1-1 (exempting the "transfer of assets effected as an exportation from this country.")

⁹¹ JAPAN CONSUMPTION TAX, *supra* note 79, at Article 4.

No Japanese CT due: The French architectural services are not subject to the Consumption Tax. The Consumption Tax is levied only on transfers of assets or the provision of services in Japan.⁹² Cabinet Order determines the place where services are provided.⁹³ There are seven categories of services listed in the Cabinet Order.⁹⁴ Either the fifth or the seventh category would seem to apply to architectural services. The fifth concerns the “provision of information or designs.” The seventh functions as a catchall provision for “services other than those mentioned in the previous items.” In both instances the place of taxation is the same. It is “the location of the office concerned in the provision of information or designs”⁹⁵ in the fifth category, or it is “the location of the office of the person providing the service”⁹⁶ in the catchall.

No French VAT due: In addition, no French VAT is due on provision of these services. This is the rule under current French law,⁹⁷ Article 9(2)(a) of Sixth Directive as currently in force,⁹⁸ as well as the rule under (New) Article 9(a) of the proposed rules.⁹⁹

Even though no Japanese CT is due on the importation, and no French VAT is due on the performance of these services, this is not a case of double non-taxation. This is not an example of the kind of non-synchronized international rules for taxing consumption that troubles the OECD.

The reason for this has to do with the operation of the deduction rules in the Japanese Consumption Tax. In effect, by excluding the cost of the French architect from taxable purchases the Japanese tax indirectly burdens the French architectural services to the same extent it would burden the importation of a similar measure of goods. The difference is a matter of timing. Consider the following example.

- a. Cost of architectural services = 100 + CT paid of 0
- b. Financial information for Japan Co.
 - i. Taxable sales 1,000 + CT collected of 50
 - ii. Taxable purchases 600 + CT paid of 30
- c. Calculation of CT return:
 - i. Total CT collected on taxable sales = $1,050 \times 5/105 = 50$
 - ii. Total CT due on deductible purchases = $630 \times 5/105 = 30$
 - iii. Net CT payable = 20
- d. Calculation of profit for Japan Co.:
 - i. Sales = 1,050
 - ii. Less:
 - a. Purchases = 630
 - b. CT = 20
 - c. Nontaxable fees paid = 100

⁹² JAPAN CONSUMPTION TAX, *supra* note 79, at Article 4-1.

⁹³ JAPAN CONSUMPTION TAX, *supra* note 79, at Article 4-3-2.

⁹⁴ AN ORDER FOR THE ENFORCEMENT OF THE CONSUMPTION TAX LAW, *supra* note 79, at Article 6-2.

⁹⁵ AN ORDER FOR THE ENFORCEMENT OF THE CONSUMPTION TAX LAW, *supra* note 79, at Article 6-2-5.

⁹⁶ AN ORDER FOR THE ENFORCEMENT OF THE CONSUMPTION TAX LAW, *supra* note 79, at Article 6-2-7.

⁹⁷ C.G.I., Art. 259 A (2°) (2005)

⁹⁸ SIXTH DIRECTIVE, *supra* note 11, Art. 9(2)(a).

⁹⁹ COM(2003) 822 final, *supra* note 8 at 11 & 18.

iii. Profit = 300

Corporate profits remain unchanged at 300. But notice, compared with the importation of goods example (example 3), the net consumption tax payable by Japan Co. is higher by 5. The reason for the increase is precisely because of the French architectural services and the fact that they are excluded from the amount of deductible purchases, even though they are real economic inputs.

As a result, the real difference between the treatment of imported good and imported services is one of timing under the Japanese CT. Where the value added by imported good is taxed at the border, the value added by imported services is taxed on the resale of goods or services into which they are incorporated.

PART III: COMPARATIVE ASSESSMENT

Mature consumption tax systems, like the EU VAT, determine the place of taxation indirectly, through proxies rather than directly, through express use and enjoyment rules. Proxy-based rules have proven to work the best. This is the clear conclusion from four-decades of EU experimentation. Borrowing from this experience, the Japanese CT relies exclusively on proxies when determining the place of taxation for services and intangibles.

The history of the EU rules is instructive. There have been four distinct phases, and we are about to enter the fourth. The EU moved from pure “use and enjoyment” criteria in the Second VAT Directive in 1967, to transaction-centric proxy-based rules in the 1977 adoption of the Sixth Directive. These rules were adjusted, extended and refined as the fiscal frontiers came down and throughout the transitional period (1991 through 2002). The current proposals do not depart from precedent. They maintain a reliance on proxies, but the application of them is different. The new proposals are cast in a party-centric (B2B verses B2C) dual-proxy structure. Adoption is expected some time before the July 1, 2006 effective date.

When comparing the EU VAT and Japanese CT this study has identified two areas where significant differences arise between the EU and Japanese systems. The first is the systemic non-taxation of distance supplies made to Japanese customers from non-established businesses located outside Japan. Different place of taxation proxies and technology-intensive registration and filing procedures allow these sales to be reached in the EU.

The second difference results in either double taxation or double non-taxation in EU-Japan B2B trade in services and intangibles. The particular outcome is determined by the structure of the transaction. The cause of this variance is the EU’s preference for using the place of establishment as a proxy, as opposed to the Japanese preference for using a proxy based on the fixed establishment from which (or to which) a service or intangible is provided (or received).

1. B2C DISTANCE (DIGITAL) SERVICES¹⁰⁰

Both Japan and the EU have long recognized that consumption taxes are inherently difficult to collect from final consumers when a service can be provided remotely across international borders. Failing to tax these kinds of services is an economic invitation for the service providers to move offshore, and reduce the cost to the final consumer. In Japan this incentive is measured at 5%; in the EU it ranges between 15% and 25%.

EU proxies – Under current rules sales to final consumers of distance services from businesses established outside the EU are taxed at the customer's location.¹⁰¹ This is accomplished through the special place of taxation rules of Article 9(2)(f) and the expansive scope of the definition of “electronically supplied services” provided by Annex L.¹⁰² Adoption of this proxy as the place of taxation for these services is a recent development.¹⁰³ The same proxy is not used in all B2C transactions for similar services – B2C transactions within the EU are treated differently.

¹⁰⁰ The term “distance services” is taken from COM(2005) 334 final at 12, where it is used by the Commission to describe collectively: “Electronically supplied services, telecommunications services, radio and television broadcasting services, as well as distance teaching [that] can be and are supplied to non-taxable person at a distance.”

¹⁰¹ Article 9(2)(f) provides that the place of taxation for these services is “... the place where the non-taxable person is established, has his permanent address or usually resides.”

¹⁰² Annex L provides the following “illustrative list” of electronically supplied services (e-mail communications are expressly excluded as an electronically supplied service):

1. Web site supply, web-hosting, distance maintenance of programs and equipment.
2. Supply of software and updating thereof.
3. Supply of images, text and information and making databases available.
4. Supply of music, films, and games, including games of chance and gambling games, and of political, cultural, artistic, sporting, scientific and entertainment broadcasts and events.
5. Supply of distance teaching.

¹⁰³ Prior to Directive 1999/59/EC the place of taxation for all distance services was at the supplier's location. This result followed from the design of Article 9. The place of taxation for services that are not specifically itemized in Article 9(2) are determined under Article 9(1)'s general rule – the supplier's location. Article 9(2) was silent before 1999. By adding a tenth indent to Article 9(2)(e) that dealt with telecommunications Directive 1999/59/EC changed the place of taxation for these services to the customer's location – but only in some instances. The tenth indent applied to customers located outside the EU and for taxable persons established within the EU but in a different Member States from the supplier – not for final consumers who received telecommunication services from business established outside the EU. In these later instances the place of taxation remained the supplier's location.

Three years later Directive 2002/38/EC made further changes. These involved radio and television broadcasting services and electronically supplied services. There were three aspects to these changes. First, in two separate indents, eleven and twelve, Article 9(2)(e) changed the place of taxation for these services to the customer's location – again only for customers located outside the EU and for taxable persons established within the EU but in a different Member States from the supplier.

Secondly, Directive 2002/38/EC added Article 9(2)(f). This article extended the reach of the new place of taxation proxy for electronically supplied services to include supplies to final consumers from business established outside the EU.

Third, an expansive definition of “electronically supplied services” is provided by Annex L. Annex L sweeps into the place of taxation rules controlled by Article 9(2)(f) many items that might otherwise have been considered exclusively within the scope of the tenth and eleventh indents on “telecommunications, or radio and television services.” Specifically, the inclusion of the “... supply of music, films, and games, including games of chance and gambling games, and of political, cultural, artistic,

Japanese proxy – Unlike the EU rules, the Japanese CT does have uniform proxies for determining the place of taxation for services and intangibles – the location of the office of the person who provides the service.¹⁰⁴ The supplier's location is the proxy applied to determine the place of taxation in B2B and B2C transactions. It remains the same for inbound and outbound transactions.

Comparative analysis: The EU is in total agreement with the Japanese in one respect – the importance of having a single proxy that applies across all comparable B2C transactions. Japan's CT has this now. If the Commission's recent proposals¹⁰⁵ are adopted the same will be true in the EU.

However, from another perspective, the EU and Japan see things in exactly the opposite way. The Japanese proxy is the complete opposite of the EU proxy for exactly the same transactions. As a result, Japan clearly loses CT on the vast majority of the B2C sales of services and intangible property made by distant businesses, businesses that are outside of Japanese tax jurisdiction.

Two questions arise: (1) which proxy for the place of taxation is more accurate, as a theoretical matter, and (2) what accounts for the decision to adopt proxies that are the polar opposites for the same transactions?

A close examination of recent Commission proposals sheds light on both of these questions. As to which proxy, the seller's or the customer's location, is the most theoretically appropriate – the EU has the superior position.

sporting, scientific and entertainment broadcasts and events” at item 4 of Annex L changes the proxy for these services – for final consumers who purchasing from a taxable person outside the EU – to the customer's location.

Recognizing that these changes in place of taxation would require businesses that were not established in the EU to collect and remit VAT on sales for the first time, a special electronic filing scheme was laid down in Article 26c to assist them. This scheme allows a single return to be filed in one Member State covering VAT due on sales to end consumers in all Member States. Taxes would be calculated at the rates applicable in each State.

Thus, through a very piece-meal progression, the rules on the place of taxation for distance services to final consumers from businesses established outside the EU became – the customer's location.

¹⁰⁴ Article 4-3-2 indicates that,

In the case of provision of services, the place at which said services shall have been provided (in case the service provided is transportation or communication or something else involving areas both in Japan and outside Japan or in other cases stipulated by cabinet order, the place shall be that stipulated by cabinet order.)

Two provisions of the Cabinet Order could apply. Both give the same result. Article 6-2-5 provides:

The provision of information or designs: the location of the office concerned in the provision of information and designs, of the person effecting the provision of the information or designs.

Article 6-2-7 provides:

Where in respect of the provision of services other than those mentioned in the previous Items, the place at which the service performed across a region in Japan or not in Japan or other service, is performed is not clear: the location of the office of the person providing the service which is concerned in providing the service.

¹⁰⁵ COM(2005) 334 final, at 12-13.

The Commission believes that the place of taxation rules for all B2C distance sales transactions (television and radio broadcasting, telecommunications, electronically supplied services and distance teaching without physical presence) should be harmonized. To do this it proposes to change the current place of taxation in the B2C fact pattern where both B and C are within the community. The current proxy requires taxation at the supplier's location¹⁰⁶ – the same as the Japanese rule. The Commission proposes to change this to the customer's location.

The Commission strongly believes that this change reaches the correct result. The function of a proxy is to come as close as possible to imposing tax at the place of true consumption. The Commission believes that in almost all cases, the place of consumption for B2C distance services is the customer's location. The Commission also believes that a harmonized rule in this area, one that is applicable across all similar B2C transactions, will level the commercial playing field.

It is difficult to argue with the logic of the Commission's position. What then accounts for the proxy variance in this area; variances that currently arise both within the EU and between the EU and Japan? The reason seems to be administrative, that final consumers are not tax collectors. Only the seller in a B2C transaction can be expected to collect and report the tax. Thus, if (a) compliance by foreign businesses is difficult, and if (b) jurisdiction to compel those businesses to collect the tax is lacking, then the assumption has been that sellers will not comply. As a result, taxation has been conceded. The mechanism for doing this has been to make the place of taxation the seller's location.

Recently the EU's approach to this problem has been address the administrative problem by employing technology to reduce reporting burdens on businesses, encouraging voluntary compliance. A special one-stop shop procedure was adopted under Article 26c¹⁰⁷ for this reason. The Commission believes that the effectiveness of the current proposal is highly dependent on the adoption of a similar one-stop shop procedure under Article 22b.¹⁰⁸ The Commission believes that its current proposal to harmonize all place of taxation for B2C distant sales transactions,

¹⁰⁶ Article 9(1)

¹⁰⁷ This was a one-stop-shop option. It allowed non-EU established businesses to select a single "Member State of identification" where they could be registered, but not be established, under a simplified arrangement. VAT from sales made throughout the EU would be determined on a destination-basis using the rates and rules of the jurisdiction where the customer resided. However the VAT collected on these sales would be paid over to the Member State of identification on a single electronic return. That tax administration was in turn obligated to redistribute the VAT to appropriate jurisdictions. Everything was required to be performed electronically. The proposal for the special scheme for digital sales can be found in COM(2000) 349 final at http://europa.eu.int/eur-lex/en/com/pdf/2000/en_500PC0349_02.pdf

¹⁰⁸ Where Article 26c is concerned with non-established taxable persons, Article 22b is concerned with taxable persons established in at least one Member State. Both schemes are paperless, fully electronic. Like the scheme under Article 26c, the Article 22b scheme allows one return to be filed for all transactions in non-established States. That return is filed with its Member State of establishment. A harmonized set of compliance rules covers the content and frequency of the return. Unlike the Article 26c scheme, all tax transfers under proposed Article 22b will be done directly. The Member State of establishment will not

... will indeed lead to additional administrative burden for the traders [impacted], but much of the inconvenience that this might cause could be addressed by those traders opting for the one-stop shop mechanism, leaving only one place where all the obligations must be fulfilled and providing an electronic means to do so. Therefore, the Commission strongly believes that this proposal can only achieve the full scale of its simplification when accompanied by the one-stop mechanism. Without this simplification the amended rules would impose disproportionate administrative burdens on business and run strongly counter to the Lisbon Strategy.¹⁰⁹

Thus, if the EU's technology-intensive one-stop shop procedure proves effective, and if Japan would like to capture the consumption tax revenues it is losing in cross-border B2C transaction in distance services, then an adjustment to Cabinet Order may be appropriate after the adoption of a similar simplification procedure in Japan. This recommendation, not specifically directed at Japan however, can be found in the OECD's February 11, 2005 report on *Facilitating Collection of Consumption Taxes on Business-to-Consumer Cross-Border E-Commerce Transactions*.¹¹⁰

2. B2B PLACE OF TAXATION PREFERENCES: LEGAL V. ECONOMIC TESTS CONCERNING THE PLACE OF TAXATION FOR SERVICES AND INTANGIBLES

When the place of taxation has been determined to be the proxy of where a business is located, and where a businesses has multiple locations in multiple jurisdictions, how should a consumption tax discriminate among possible competing locations? The fundamental question boils down to whether the proxy adopts a legal or an economic test. There are four common formulations of a businesses location: (1) the place of establishment or head office, (2) the place of a fixed establishment from which or to which a service or intangible is provided or received, (3) the place of permanent address and (4) the place of usually residence.

The first and second tests are globally dominant. The first is a legal test; it looks to the place of legal control. The second is an economic test; it looks to the place of economic incidence, the place where a service or intangible is actually provided or used.

redistribute funds for the taxpayer. Each taxable person must make payments directly to each Member State of consumption. National rules governing declaration periods, as well as various payment and refund rules must still be complied with on a country-by-country basis. COM(2004) 728 final. Available at: http://europa.eu.int/comm/taxation_customs/publications/official_doc/COM_728_en.pdf. See Richard T. Ainsworth, "The One-Stop Shop for VAT and RST; Common Approaches to EU-US Consumption Tax Issues," TAX NOTES INTERNATIONAL (Feb. 21, 2005) 693.

¹⁰⁹ COM(2005) 334 final at 13.

¹¹⁰ OECD: PROGRESS REPORT AND DRAFT PRINCIPLES 4 *supra* note 6.; *see also* OECD, REPORT ON AUTOMATING CONSUMPTION TAX COLLECTION MECHANISMS 13-14 (1-2 July 2003) DAEFFE/CFA(2003)43/ANN5 available at <http://www.oecd.org>.

Article 9(1) and 9(2)(e) of the Sixth Directive present these four criteria in a cascading sequence, setting out the place of taxation as "... 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." The same language appears in (New) Article 9(2). This is the new "main rule" for B2C transactions. Similarly Article 9(2)(e) sets the place of taxation at "... the place where the customer has established his business or has a fixed establishment to 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." The same language appears in (New) Article 9(1). This is the new "main rule" for B2B transactions.

EU proxy: The clear preference in the EU is for a legal test. The ECJ has determined that the place of taxation for services and intangibles is the place of establishment, and the proxy of a fixed establishment (through which a service is provided or to which it is received) is a distant second best. In two separate cases the ECJ has stated that a fixed establishment is to be used, "... only if the reference to the place where the supplier has established his business does not lead to a rational result for tax purposes or creates a conflict with another Member State."¹¹¹

Japanese proxy: The clear preference in Japan is for an economic test. In four of the seven specified categories of services,¹¹² including the catchall final category, the Cabinet Order looks to the office most directly involved in the performance or receipt of the service to determine the place of taxation.¹¹³

Comparative analysis: This divergence in proxies for the place of taxation leads to both double taxation and (at least in some instances) to double non-taxation in Japanese-EU trade of services and intangibles. Two examples will demonstrate.

EXAMPLE 1: DOUBLE TAXATION

Assume two companies established in different countries in the EU. One is a German computer company that sells global ERP systems; the other is a French bank with global operations. Assume that both firms have branches in Tokyo, Japan. Assume also that the French bank enters into an agreement to purchase and have installed a global instance of the German firm's ERP system. As a result of this agreement, the German computer firm will provide installation services to the French bank in each of its branches, including the branch in Tokyo.

¹¹¹ Berkholz, *supra* note 31 at 17 (determining that the place of a slot machine's business establishment in Hamburg should control the place of taxation for services rendered through slot machines on ships sailing between Germany and Denmark); Case 231/94, Faaborg-Gelting Linien A/S v. Finanzam v. Flensburg, 1996 E.C.R. 2395; 3 CMLR 535 (1996) at 11 (determining that the place where a restaurant is established in Denmark should control the place of taxation for restaurant services provided on a ships sailing between Denmark and Germany).

¹¹² The remaining three categories employ an unusual dual-proxy. See *supra* text accompanying note 84.

¹¹³ See *supra* text accompanying notes 85-88.

Double taxation (the Japanese CT): If the German firm renders these services out of its Tokyo branch office, then it is clear that the Japanese CT will apply. Either Article 6-2-5 (dealing with the provision of information or designs) or Article 6-2-7 (the catchall provision) of the Cabinet Order will control, and the place of taxation will be in Japan because this is where the “office of the person providing the service” is located.¹¹⁴

Double taxation (the French VAT): If the contract is between the German and French firm, an invoice will issue, and the French firm will be required to apply the reverse charge procedures under Article 21(1)(b). The place of taxation is determined under Article 9(2)(e) as the place where the customer has established his business. The third indent of Article 9(2)(e) (services of consultants, engineers, ... as well as data processing and the supplying of information) applies to these services whether or not they are actually rendered in the EU.

This result is consistent with the position of the EU Commission. In a recent Working Paper the Commission follows the reasoning of the ECJ in the Berkholz and Faaborg-Gelting cases and argues that the contractual relationship of the service provider and the customer must be analyzed. It concludes that if a service is contracted, invoiced and paid by the customer at his place of establishment, then this place should be determined to be the place of taxation.¹¹⁵ A recent case by the UK VAT Tribunal agrees with this result.¹¹⁶

EXAMPLE 2: NON-TAXATION

Assume the facts are reversed and there are two Japanese firms, both established in Tokyo, Japan. One is a computer firm that sells global ERP systems; the other is a bank with global operations. Assume that both firms have branches in Paris, France. Assume also that the bank enters into an agreement to purchase and have installed a global instance of the computer firm’s ERP system. As a result of this agreement, the computer firm will provide installation services to the bank in each of its branches, including the branch in Paris.

Non-taxation (the French VAT): Applying the principles of the Berkholz and Faaborg-Gelting cases, the EU Commission’s Working Paper No. 498, and the holding in the Zurich Insurance case, it is clear that the place of taxation for all installation services is Japan – even if the services that are provided by the branch of the computer firm to the branch of the bank in Paris, France. The whole transaction is out of scope of the French VAT.

¹¹⁴ See: Basic Consumption Tax Ruling 7-2-6 (Shouhizeihou Kihon Tsuutatsu 7-2-6) (concerning the taxation of overseas package tours provided by travel agents determining that services performed out of offices located in Japan were subject to the consumption tax, but those provided out of offices located outside of Japan were not subject to the consumption tax).

¹¹⁵ EU Commission, “Working Paper No. 498,” (May 2, 2005) TAXUD/1628/05-EN.

¹¹⁶ Zurich Insurance Company v. HMRC (LON/02/1080) June 30, 2005 (holding that a contract between PwC and Zurich Insurance in Switzerland for a global installation of a SAP ERP system was not subject to UK VAT even though services were actually performed in the UK by the UK branch of PwC, and those services were paid for by the UK branch through an inter-company charge between the Swiss headquarters and the UK branch).

It is also clear that transferring the benefits of the Japanese contract (intra-company) from the Japanese head office to the French branch is not a transfer subject to French VAT.¹¹⁷ This will be the case even though there is an intra-company charge between the French branch and the Japanese head office of the bank. This fact pattern is anticipated and resolved in the Commission's B2B proposals where a new Article 6(6) is contemplated that would state:

Where a single entity has more than one fixed establishment, services rendered between the establishments shall not be treated as supplies.¹¹⁸

Non-taxation (the Japanese CT): It is also clear that the services provided through the German branch of the Japanese computer firm to the branch of the Japanese bank located in Paris, France is not subject to the Japanese CT. Once again either Article 6-2-5 (dealing with the provision of information or designs) or Article 6-2-7 (the catchall provision) of the Cabinet Order will apply, and the place of taxation for these services will be France, because this is where the "office of the person providing the service" is located.¹¹⁹

However, as was apparent in the examples used to describe the operation of the Japanese CT when services are purchased overseas for the benefit of a Japanese business the operation of the CT effectively imposes the tax by not allowing a deduction for the cost of the services performed overseas.¹²⁰ The difference between the treatment of imported goods and imported services under the CT was shown to be one of timing. Although the CT is imposed on goods upon importation, they are imposed on services not on importation, but upon resale of the products into which they are incorporated.

In this instance however, the subsequent supply is exempt from the CT. The financial services offered by banks are exempt in Japan as they are in most consumption tax regimes.¹²¹ Thus, there is no CT imposed.

CONCLUSION

¹¹⁷ C-210/04, Ministero dell'Economia e delle Finanze and Agenzia delle Entrate v FCE Bank plc, Opinion of Advocate General Léger (September 29, 2005) available at: <http://curia.eu.int/en/content/juris/index.htm> [in Italian, French, German, Greek, Portuguese, Finnish and Swedish, but not at this writing in English] (determining that intra company supplies of services between the head office and a branch in different Member States is not subject to VAT); Zurich Insurance, *supra* note 119 (reaching the same result between a head office not in a Member State and a branch within a Member State).

¹¹⁸ COM(2003) 822 final at 10 & 17 ("This position conforms the Commission's view and that of a great majority of Member States. Where services are rendered within the same legal entity (e.g., a service rendered by a head office to a branch), they are not considered to be supplies for purpose of the Sixth VAT Directive. This is the case where the establishments are within a single Member State or multiple countries. Services rendered between legal entities (e.g., head office and a wholly owned subsidiary) are supplies.")

¹¹⁹ See: Basic Consumption Tax Ruling 7-2-6 (Shouhizeihou Kihon Tsuutatsu 7-2-6) *supra* note 117.

¹²⁰ See example 4, *supra* at text accompanying notes 93-100.

¹²¹ AN ORDER FOR THE ENFORCEMENT OF THE CONSUMPTION TAX LAW, *supra* note 79, at Article 6-1 and Appendix I.

Although the EU Commission is contemplating major changes in the place of taxation rules for services and intangibles, at least with respect to transactions between the EU and Japan these changes will do nothing to eliminate the double taxation or double non-taxation in B2B transactions that currently exist.

These reforms do however reinforce earlier efforts of the EU to impose the VAT on sales to EU final consumers from businesses not established in the EU. This area has been problematical for Japan. If Japan wishes to impose its CT on similar B2C transaction it should consider reforming its place of taxation rules for these transactions in a manner similar to that of the EU.

However, the EU experience is that this change should not be just one of changing the place of taxation. In conjunction with this change Japan should consider adopting the electronic filing and reporting procedures adopted by the EU in its one-stop shop efforts under Article 26c and proposed Article 22b. Moving in this direction would also be in harmony with OECD recommendations.

In the area of B2B transactions involving cross-border supplies of services and intangibles much remains to be done. Nothing in the recent proposals for change in these rules by the EU Commission addresses these issues. In fact, in the instance where new Article 6(6) is proposed, the Commission is in fact facilitating the kind of double non-taxation set out in the final example above.

Thus, the OECD is correct in its assessment, at least with respect to Japan-EU trade. There are clear opportunities for tax avoidance, as well as an unintended erection of double taxation trade barriers. These conditions do indeed arise out of a “lack of international consistency and coherence.”¹²²

¹²² OECD, REPORT: THE APPLICATION OF CONSUMPTION TAXES TO THE TRADE IN INTERNATIONAL SERVICES AND INTANGIBLES, *supra* note 3 at 7.