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VAT AND THE TELECOMS INDUSTRY – A UK PERSPECTIVE

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Introduction

The application of VAT in respect of telecommunication services was one of the hot topics of the 1990s but the ongoing debate in relation to e-commerce has now diverted attention away from the issues faced by "traditional" telecoms providers. However, in an economic climate where an unexpected VAT liability (or even a VAT cashflow) can make or break a struggling telecoms company, the EU's telecoms specific VAT rules introduced in the 1990s take on a new significance. This article seeks at least momentarily to redirect the spotlight to focus on the issues faced by telecoms companies in the practical application of those rules and the need for greater consistency in the application of consumption taxes both inside and outside the EU.

It is useful first to recap on the EU rules themselves and the rationale behind their introduction.

The Changing Face of Telecoms

The 1990s saw the telecoms industry reinvent itself through the transition from public to private market services and the resulting vastly increased consumer choice, all of which prompted a need for change in the way the industry had previously been taxed.

Prior to the privatisations of the state monopolies that began in the 1980s, tax had not represented a significant issue. The public sector operators, commonly referred to as PTOs - which stood for what now seems the very old fashioned term, "Postal

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and Telecommunications Operators" – had generally escaped the tax net by reason of their public body status. However, with the continuing evolution of cross border supplies of wholesale telecommunications services and the entry of private operators into the market (although not initially the EU), internationalisation began to take hold and tax – including consumption tax – became relevant.

The Melbourne Agreement

The commercial issues raised by these changes to the telecoms industry were discussed at the 1988 conference of the UN International Telecommunication Union. The resulting "Melbourne Agreement"[2] prescribed international procedures on a number of aspects of the telecommunications industry, including a settlement system whereby accounts for services rendered by PTOs or similar operators in different countries would be netted off against accounts for services rendered to them, with the difference being settled quarterly.

The Melbourne Agreement, which was signed by 112 countries, also provided that no taxation should be imposed by one country on another country's public telecom authority or similar operator in relation to wholesale supplies of cross-border voice and data transmission services.

The Agreement came into effect on 1 July 1990 in all the signatory states. However implementation and application was not consistent. In the EU, the Melbourne Agreement was generally implemented with reference only to state PTOs since, broadly speaking, they were the only players in the EU at the time. In any event, Member States had reserved the right not to implement provisions contrary to the Sixth Directive and the zero rating of supplies of telecommunication services was not permitted by the Sixth Directive.

EU Deregulation and Imposition of VAT

As the technology developments gathered full momentum, the early 90s saw deregulation extend to the EU telecoms industry. Private market services became available in Member States offering, for example, call back services by which private operators sought to undercut the PTOs' prices.

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2 The final acts of the World Administrative Telegraph and Telephone Conference of 1988.

The Member States responded by imposing VAT charges on telecoms services, in accordance with Article 9(1) of the Sixth Directive, which provides that the place of supply is where the supplier belongs. Whilst this approach was initially successful in generating increased VAT revenue for the Member States, it became clear that, from a competition perspective, the application of VAT by reference to the place of belonging of the supplier was distortive and there was uncertainty and inconsistency in the application of the Melbourne principles to wholesale supplies between private market operators.

The problems became more pronounced as the industry expanded, and with the principle of neutrality clearly jeopardised, the Member States worked together during the mid-1990s to consult on a solution. This came first in the temporary form of derogations from the Sixth Directive formalised by Council Decisions in 1997[3] (the "Derogation") and was followed in 1999 by a Directive[4] (the "Telecoms Directive") which amended the Sixth Directive.

The Competition Problem

The application of Article 9(1) - the basic supplied where the supplier belongs rule - to determine VAT liability upon the supply of telecommunication services meant that final consumers and exempt/partially exempt businesses for whom VAT constituted, at least to some extent, a real cost, were able to obtain telecom services from outside the EU on a low VAT or VAT free basis. Technological developments such as satellite had made it possible for third country operators to provide telecoms services in the EU without creating a fixed establishment and therefore without the need to charge EU VAT.

EU based telecoms businesses were inhibited from participation in the global market beyond the EU because the need to charge VAT hindered their ability to compete effectively, and even within the EU, the VAT refund procedure was generally found to be too cumbersome in practice to eliminate the competitive disadvantage.

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3 In the case of the UK, 97/214/EEC - Council Decision of 17 March 1997 Authorising The United Kingdom To Apply A Measure Derogating From Article 9 of the Sixth Directive (77/388/EEC) On The Harmonisation Of The Laws Of The Member States Relating To Turnover Taxes (OJ L86, 28.3.1997, P33).

4 Council Directive 99/59/EC of 17 June 1999 Amending Directive 77/388/EEC As Regards The Value Added Tax Arrangements Applicable To Telecommunication Services.

The economic consequences of these competition problems were compounded by the inevitable VAT planning activities of aggrieved EU telecoms companies who set up fixed establishments outside the EU for the purpose of making supplies into the EU, so avoiding the need to account for EU VAT and, of course, despite the trend towards globalisation, non-EU telecos were careful to give any physical presence in the EU a wide berth.

These problems slowed the growth of the industry within the EU, causing the treasuries of Member States to miss out on potential revenue. It was soon recognised that the prevailing VAT treatment was bad news both for the EU telecoms industry and for the EU economy.

The Derogation

To save the time necessary in agreeing a new directive, it was decided that the necessary changes should be made by way of a derogation from the Sixth Directive signed up to by all Member States. Applications for derogations were made prior to the end of 1996.

The short-term solution provided by the Derogation was to authorise but not compel Member States to treat telecoms services as if they fell within Article 9(2)(e) of the Sixth Directive - i.e. services that are supplied where the recipient belongs. Supplies to recipients outside the EU would therefore fall outside the scope of EU VAT, subject to the application of certain "use and enjoyment" rules provided by the Derogation. Consistent with that approach, telecoms services became "reverse charge" services so that where supplies were received by an EU business, VAT operated in the Member State in which they were received.

The use and enjoyment provisions mentioned above added a layer of complexity however. The Derogation provided that where a Member State made use of the Article 9(2)(e) treatment, it must also apply certain effective use and enjoyment provisions which were otherwise merely permitted by Article 9(3)(b). The provisions apply where telecoms services that would otherwise be treated as supplied outside the EU are used and enjoyed by non taxable persons in a Member State and cause the Member State in which such use and enjoyment takes place to become the place of supply for VAT purposes. Therefore the supply is brought within the scope of that Member State's VAT regime.

As a result of these additional rules, Member States could now ensure that VAT applied to supplies received in the EU by final consumers from third country suppliers, so avoiding the non-taxation and distortion of competition that had previously blighted B2C services. Third country suppliers became liable to register

in Member States where their services were effectively used and enjoyed subject, of course, to any applicable registration threshold and the operation of the reverse charge mechanism.

UK Implementation of Derogation

In the UK the Derogation was implemented with effect from 1 July 1997 and the amendments made at that time remain in force today. Schedule 5 of the Value Added Tax Act 1994 was amended[5] to include telecommunication services with the result that such services fall within the reverse charge provisions and the "supplied where received" provisions of the Value Added Tax Place of Supply of Services Order 1992.

The UK in fact went further than required by the Derogation by implementing Article 9(3)(b) of the Sixth Directive in full so that not only supplies used and enjoyed by non taxable persons in the UK are within the scope of UK VAT (where not otherwise taxable in the EU) but so are *any* telecoms supplies used and enjoyed in the UK which are not otherwise taxable in a Member State.

In practice, if the recipient is a taxable business, it is possible for the reverse charge to operate so that the third country supplier does not need to register in the case of such supplies. However if the customers are private consumers, registration would be necessary assuming the registration threshold is reached.

The breadth of the UK's use and enjoyment rules created some concern in the US as to the treatment of tourists and business travellers. Certain concessionary practices were consequently agreed, the detail of which is outside the scope of this article.

Not content with the full implementation of Article 9(3)(b) the UK (and several other Member States) also implemented Article 9(3)(a) which shifts the place of supply out of a Member State where use and enjoyment occurred outside the EU. This gives operators in these Member States a competitive edge at the expense of VAT revenues but is aimed at avoiding double taxation.

For example, an EU resident using a mobile telephone outside the EU under a contract with a UK provider would escape UK VAT as a result of this provision as his use and enjoyment is outside the EU - whereas if he used a telephone under a

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5 By Value Added Tax (Reverse Charge) (Anti-Avoidance) Order SI 1997/1523, Art 3.

contract with an operator in a Member State which had not implemented the Article 9(3)(a) rule, he would still be liable to VAT of that Member State. This could result in double taxation where the overseas operator that actually provides the services (under roaming agreements with the customer's contractual operator) charges the EU operator VAT under its local laws which the EU operator cannot recover and so passes on to the customer.

The Telecoms Directive

The authorisations given to Member States in 1997 by the Council to derogate from the Sixth Directive were time limited to 31 December 1999. This gave sufficient time for a new directive to be agreed and on 17 June 1999 the new Telecoms Directive was issued.

The Telecoms Directive amended the Sixth Directive without much significant change from the Derogation rules.

The effect of the Telecoms Directive is to make mandatory (whereas the Derogation only permitted) the "supplied where the recipient belongs" treatment and to apply the use and enjoyment provisions to bring supplies of telecommunication services to non taxable persons in the EU into the charge to EU VAT where such supplies would otherwise be outside the scope of EU VAT. The Telecoms Directive did not go as far as the rules adopted by the UK outlined above.

The Telecoms Directive retained the "reverse charge" on intra EU business to business transactions despite a Commission proposal to remove it in such circumstances. The Council dismissed this idea on the basis of the VAT rate shopping to which it was likely to lead within the EU. Without a reverse charge mechanism, EU operators were likely to establish themselves in the Member State with the lowest VAT rate.

The Commission also sought to simplify registration administration for third country operators and proposed a single place of registration to cover all EU transactions[6]. Again, the Council dismissed this proposal because of the lack of harmonisation of VAT rates across the EU. The Council saw that companies would register where the rate was lowest with the effect that all VAT revenue in respect of EU transactions flowed to that single Member State. The undesirable cashflow consequences of the

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6 In the light of the Commission losing this battle in the late 1990s in respect of telecoms, it does seem surprising that the EU's draft E-Commerce Directive was drawn along similar lines. It is less surprising that the proposal has met similar resistance.

Eighth Directive refund system were not attractive.

The Telecoms Directive required no further implementation in the UK and the UK position remains as it had been following the amendments made following the grant of the Derogation (described above).

The Use and Enjoyment Rules

Scope of concept

As noted above, the circumstances in which use and enjoyment rules apply vary between Member States with some Member States, such as the UK, having gone further than required by the Telecoms Directive. In addition, different approaches to the interpretation of "effective use and enjoyment" (or "effective use or enjoyment" as it is legislated in some Member States) are taken across the Member States, so that the application of the use and enjoyment rules can prove something of a grey area even where it is established that the rules are relevant.

Italy takes an unusual approach to use and enjoyment by actually including a definition in its VAT legislation which provides that a service is used and enjoyed in Italy if the signal starts or the service is paid for, bought or ordered in Italy.

Some Member States such as Germany have limited the application of the rules to use and enjoyment by EU residents whereas France has restricted the provisions to use and enjoyment by French residents. As mentioned previously the UK has adopted a broad approach catching all consumption of telecoms supplies in the UK and as a result has had to create practical concessions regarding tourists and business travellers. The detailed rules therefore still differ from Member State to Member State.

Wholesale supplies

The definition of "telecommunications services" (discussed further below) includes wholesale supplies between telecoms operators. Accordingly, the use and enjoyment rules also apply to such supplies. The Telecoms Directive did not specify whose use and enjoyment was relevant and therefore it is arguable on the basis of the relevant legislation that the use and enjoyment provisions should operate by reference to where the customer of the operator acquiring the wholesale services uses and enjoys them. However, this would be a hopelessly impractical approach for a tax authority to adopt - it would be impossible for the first operator to know whether and how much VAT to apply on such a basis.

The better view is that the use and enjoyment rules seek to determine the place at which the services have their economic consequences – and that in the case of wholesale supplies this is determined not by their ultimate consumption but by the location of the business or other relevant fixed establishment of the operator acquiring the services. Therefore, in practice, the use and enjoyment rules should not affect the operation of VAT on wholesale supplies.

It is understood that this is the approach currently taken in practice in the UK by HM Customs & Excise in relation to interconnection services so that unless a wholesale customer acquiring services has a fixed establishment in the UK, UK VAT will not be applicable. However, UK wholesale providers should anticipate the possible changes envisaged by the draft E-Commerce Directive, for example in respect of the services they provide to ISPs, and ensure they retain the right to charge VAT in their contracts with such customers. If non EU ISPs are forced to register in the UK as a result of the supplies they make in the UK (whether or not they have a fixed establishment in the UK), then it is likely that the wholesale supply of telecoms to such provider may become liable to UK VAT.

Interbranch transactions

An additional issue arises in relation to interbranch transactions where an international business uses telecoms services in its various international branches. Some Member States appear to require such a branch to reverse charge the services as if it were a subsidiary despite, strictly speaking, there being no supply for the purposes of the Sixth Directive.

The UK has taken a different approach and applied the use and enjoyment rules[7] to require a UK branch receiving services from a non EU telecoms supplier to account for the reverse charge on the basis that the services are used and enjoyed in the UK, so avoiding the need for the third party supplier to register in the UK. Where the third party supplier is a UK telecoms company, UK VAT has to be charged on the portion of the services used by the UK branch. This produces grey areas of allocation of consideration, and in the case of some types of services, for example bandwidth services, it is not always possible to monitor where the services are used and the requirement for the UK supplier to charge VAT in such circumstances becomes difficult to administer.

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7 In conjunction with Article 21(1)(b) of the Sixth Directive which provides for the recipient to be liable for VAT in the case of supplied where received supplies.

Practical Application of UK VAT to Supplies of Telecoms Services

As we have seen the VAT position that has been reached in respect of telecoms is not straightforward, and in the light of the complex rules they have to operate in order to determine their VAT liabilities and compliance responsibilities, telecoms operators need to know their customers and monitor how and where they use the services provided to them. In relation to their business with or within the UK, a summary of these knowledge requirements and their implications for VAT liability is shown in diagrammatic form in Tables A and B.

UK Suppliers

Table A considers the information a UK telecoms supplier needs in order to determine, charge and account for the UK VAT liability on the services it provides.

The first question for a UK supplier is where the customer belongs. In the UK, this is determined by the business or fixed establishment at which or for the purposes of which the supply is most directly used or in the case of a customer having no such establishment, at the customer's usual place of residence. Of course, this of itself is not always a straightforward issue. Regard should be had according to the *Berkholz*[8] case to whether the establishment has permanently available the minimum size and human and technical resources necessary for the provision of the services in question[9].

In the case of a supply to a person belonging in the EU, it is necessary to know if the customer is a taxable person. If taxable, the reverse charge mechanism applies.

In the case of a supply to a person belonging outside the EU or belonging inside the UK, or to a person belonging in the EU who receives the supplies for non business purposes, it is important to know where the supply is used and enjoyed as this could either bring the supply into or take the supply out of UK VAT.

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8 *Gunther Berkholz v Finanzamt Hamburg Mitte-Altstadt,* ECJ 4 July 1985, C-168-84.

9 It will be interesting to see how the human resources requirement stands up over time, particularly in the context of recent developments at OECD level in respect of the direct tax concept of permanent establishment for the purposes of e-commerce. Introductory comments to changes to the OECD commentary on the OECD Model Tax Convention adopted by the Committee of Fiscal Affairs on 22 December 2000 indicate that human intervention is not a requirement for the existence of a permanent establishment.

Non UK Suppliers

The questions relevant to the determination of a non UK supplier's UK VAT liability (whether that supplier belongs inside or outside the EU) are set out in Table B.

A non UK supplier making supplies to a person belonging in the EU (but not in the UK) will only need to consider whether use and enjoyment is in the UK if both the supplier belongs outside the EU and the customer does not receive the services for business purposes.

A non UK supplier may fall within the charge to UK VAT where the customer belongs outside the EU if use and enjoyment is in the UK. However if the customer has a UK VAT registration this can be used to operate the reverse charge and avoid identification of the third party supplier in the UK.

Therefore in the case of non UK suppliers, use and enjoyment will normally only create an actual liability to UK VAT for the overseas operator in practice to the extent it makes supplies to non taxable persons. (In a case of this type of supply it is generally easier for an operator to identify where use and enjoyment takes place.) If services are used outside the EU by a UK business, the use and enjoyment rules will enable a non UK supplier to avoid a UK VAT liability in respect of its supply to the UK business.

Meaning of "Telecommunications Services"

The use and enjoyment rules are not the only complexity in the application of the VAT regime to telecoms services. The scope of "telecommunication services" is itself an evolving concept.

Definition

The Sixth Directive (as amended by the Telecoms Directive) provides the following definition of telecommunications services:

> "Telecommunications services shall be deemed to be services relating 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."

The definition is an attempt to combine the conflicting needs of the industry - the need for certainty and clarity to enable compliance and the need for flexibility to cope with the technological advances which are constantly changing the face of telecoms.

As noted above, the definition encompasses both wholesale and retail telecoms services and in a statement for the Council minutes published in conjunction with the introduction of the Telecoms Directive, the Commission and Council have also clarified that the definition includes standard connections, subscriptions and communications using two way devices, the provision of telecoms networks, the right to use separate lines for a network and internet access for a standard fee (connection and exchange of information only).

The preamble to the Directive makes clear that call routing services and termination services are covered.

Internet services

In the UK further guidance is given in HM Customs & Excise Notice 741[10] to the effect that basic access to the internet, the provision of email addresses and chatline facilities are all telecommunications services. If basic internet access is accompanied in a package by related software, some information and support facilities, the UK still treats the entire supply as a supply of pure telecoms services to which the special telecoms rules apply but where the emphasis is on content rather than communication, the place of supply is said to depend upon the nature of the services provided.

A Business Brief published by UK HM Customs & Excise in 1997[11] acknowledged that in the case of many internet packages provided for a single inclusive price, it is not possible to determine accurately whether telecoms services predominate. As a result, the tax authority said that the use and enjoyment provisions of the telecoms regime will not be applied with the result that supplies to non taxable persons in the UK by non EU providers would escape VAT.

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10 Paragraph 11.38.

11 BB/22A/97.

However minutes of recent UK E-VAT Forum meetings[12] note that things have moved on and that overseas businesses now include in their packages for a flat fee the telecoms element previously supplied by a telecom provider direct to the consumer. No UK VAT is being accounted for on these telecoms supplies on the basis of the 1997 Business Brief and this is said to be distorting competition with UK business. The minutes suggest that the Business Brief may be replaced in order to remedy the problem. As at August 2001, the review of this issue was reported to remain ongoing.

The review of the Business Brief mentioned above will be interesting in the light of final determination of the *Card Protection Plan*[13] litigation in the House of Lords earlier this year in respect of multiple and composite supplies. HM Customs & Excise needs to assist telecoms/e-commerce companies by ensuring a balance is struck between the need for a level playing field and the provision of clear and practical guidance as to their VAT obligations.

Mixed and Composite Supplies

The issue of multiple and composite supplies is of course a concept which is notorious for its difficulty and inconsistency of interpretation even in the courts - creating considerable problems in practice for those seeking to account properly for VAT. The *Card Protection Plan* case is a frightening example of the uncertainty comprised in this VAT concept. That case took over ten years to be resolved by the courts and the principles enunciated are still open to broad interpretation.

In its consideration of the issues raised, the European Court of Justice ruled[14] a supply of services which comprised a single service from an economic point of view should not be artificially split, because to do so would distort the functioning of the VAT system. The essential features of the transaction have to be ascertained in order to determine whether the supplier is making a supply to the customer of several distinct principal services or of a single service. There is a single supply in cases where one or more elements can be regarded as constituting the principal service, whilst one or more other elements are to be regarded, by contrast, as merely ancillary services which shared the tax treatment of the principal service.

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12 The minutes of these meetings are posted at www.inlandrevenue.gov.uk/e-commerce/ecom12d.htm.

13 *Card Protection Plan Ltd v Customs and Excise Commissioners* (2001) UKHL/4.

14 *Card Protection Plan Ltd v Customs and Excise Commissioners*, 25 February 1999, Case C-349/96.

A service is to be regarded as ancillary to the principal service if it does not constitute for customers an aim in itself, but the means of better enjoying the principal service supplied.

This suggests that the motive of the customer in making its acquisition is relevant for the purpose of deciding whether there is a single supply. This brings its own difficulty - different customers may have different motives. Should the supplier focus on a typical customer? Is the supplier best placed to determine the motive of its customer?

The ECJ also pointed out that charging a single price for a package of services is only indicative of a single supply and not conclusive.

In addition to the question of internet packages discussed above, the issue of multiple and composite supplies creates grey areas elsewhere in the telecoms arena, for example in respect of operation, administration and maintenance services, colocation services and network management all of which may be bundled together with/as telecoms services. An operator needs to analyse its supplies on a case by case basis (taking into account the differences in practice in different countries including the Member States) in order to determine whether all aspects of its supplies are governed by the specific telecoms rules in the relevant jurisdiction or whether different place of supply rules apply requiring different VAT treatment of any non-telecoms services.

Operation and maintenance services are frequently included as part and parcel of the telecoms contract and there are strong arguments that these services constitute ancillary services but where the services are in fact rendered by a third party, this may shift the balance.

Colocation services entail the hosting of equipment - usually without any grant of property rights - and are usually sold together with capacity rights in order to enable the customer to link up to the network and enjoy the telecoms services properly. It is thought that these types of services may be regarded as having more substance than merely ancillary activities but there remains an argument that colocation services are themselves telecoms services on the basis that they are included in the concept of the grant of capacity. It is understood that UK HM Customs & Excise take a case by case approach depending on the terms of the contract but in the absence of evidence of a property licence to occupy, the tendency is to treat such services as telecoms services.

The practice is less clear in other jurisdictions but to treat colocation services as supplied where the supplier belongs will lead to similar distortion to that experienced

prior to the 1997 changes to the telecoms regime and we could expect to see colocation facilities moving outside the EU to avoid EU VAT.

Network management services involve the monitoring of performance, security and default and accounting management. Again the question is whether such services can be regarded as principal services and if so, do such services constitute telecoms services. Some Member States are clear on this and regard such services as independent services of an advisory nature so that the telecoms rules do not apply whilst other Member States determine the VAT liability by reference to the mixed/composite supply tests.

From a practical point of view, an operator should always check the available guidance in the countries with which it is dealing. Where the treatment is likely to boil down to the mixed or composite supplies test, the desired treatment should be identified and care should be taken not just with pricing and contractual documentation - where recitals are a useful tool to demonstrate a customer's purpose - but also with promotional material[15]. So far as possible pricing should be packaged where a single supply is intended.

Dark fibre

There remain other areas of uncertainty in the scope of telecommunications.

For example, how should VAT apply to sales of rights over dark fibre (frequently structured as "indefeasible rights of use")? The significance of the fibre being dark is that it is not yet in use - does this prevent its characterisation as the transfer of capacity? It is understood that the approach of most EU tax authorities including the UK is to treat the supply of rights over dark fibre as the supply of telecommunications services on the basis that the Telecoms Directive includes in the definition of telecoms services the "transfer or assignment of the right to use capacity". However, this remains as a contentious point within the industry where overseas providers would prefer to characterise the arrangement as a licence in order to avoid the supplied where received rules required by a telecoms analysis. Again, this is an area where differences in approach can lead to double or non taxation.

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15 The UK High Court case of *Sea Containers Services Ltd v Commissioners of Customs & Excise* (2000) STC 82 demonstrates this point. In the analysis of what the customer was paying for in that case, regard was had to the prominence of the catering in the supplier's advertisements.

Status of Melbourne Agreement

Finally, to add to the complexity of the VAT rules at EU level, the continuing status of the Melbourne Agreement on a broader international level has become confused as a result of the massive changes over the last decade as technology has advanced and the industry has become dominated by private market services, leading to inconsistency between EU and non EU practices in respect of wholesale supplies.

Unlike other Member States, the UK had until the 1997 changes honoured the Melbourne Agreement by zero rating VAT on settlement charges on mutual supplies between UK and non UK recognised operators – in other words its application was not restricted to PTOs and the effect of the 1997 changes was substantially to implement the Melbourne Agreement by taking most cross border wholesale supplies of telecoms services outside the scope of UK VAT in any event[16].

However, the Melbourne Agreement was of course an international agreement involving many more countries than just the EU Member States. The issues remain very relevant once non EU VAT is involved – a good example is international roaming services where economic double and non taxation can both occur depending upon the countries in question.

In order for EU based telecoms companies to manage their exposure to consumption taxes beyond the EU, the industry needs a further global initiative to achieve consensus and consistency in the application of consumption taxes to telecoms, including a review of the continuing scope of the Melbourne principles and the extent to which signatories of the Melbourne Agreement apply the principles in practice to supplies private market operators.

Summary – A Need for Clarification

Telecoms is now unquestionably a global business and every inconsistency in rules and interpretation between jurisdictions – including the purportedly harmonised jurisdictions of the EU – increases not only the risk of economic double or non taxation but also the administration costs of dealing with other jurisdictions. These inconsistencies can become an obstacle to business.

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16 Under the new rules however UK VAT would still be chargeable where the use and enjoyment rules apply to bring a supply to a non EU telecoms company back into the UK – and although this scenario is unlikely in the context of wholesale supplies - the UK has said that by way of concession it would apply Melbourne in such circumstances - see Customs & Excise Manual Vol VI, Part 4, Chapter 3, Appendix F.

The scope of telecommunication services remains blurred at the edges and inconsistency in the application of the EU rules across the Member States brings compliance difficulties to the problems that operators already face where the EU rules do not dovetail smoothly with the application of consumption taxes outside the EU.

There is no substitute in the current international VAT climate for telecoms companies appropriately auditing the VAT regimes in the jurisdictions in which and with which they do business, understanding the VAT objectives of their own businesses and drafting their documentation and advertising materials accordingly. Maintaining a constructive dialogue with the relevant tax authorities is likely to prove invaluable and will also assist in ensuring that that plight of the telecoms industry in battling with the complexities and inconsistencies described in this article does not get totally lost whilst the e-commerce VAT debate continues to steal the limelight.

Table A

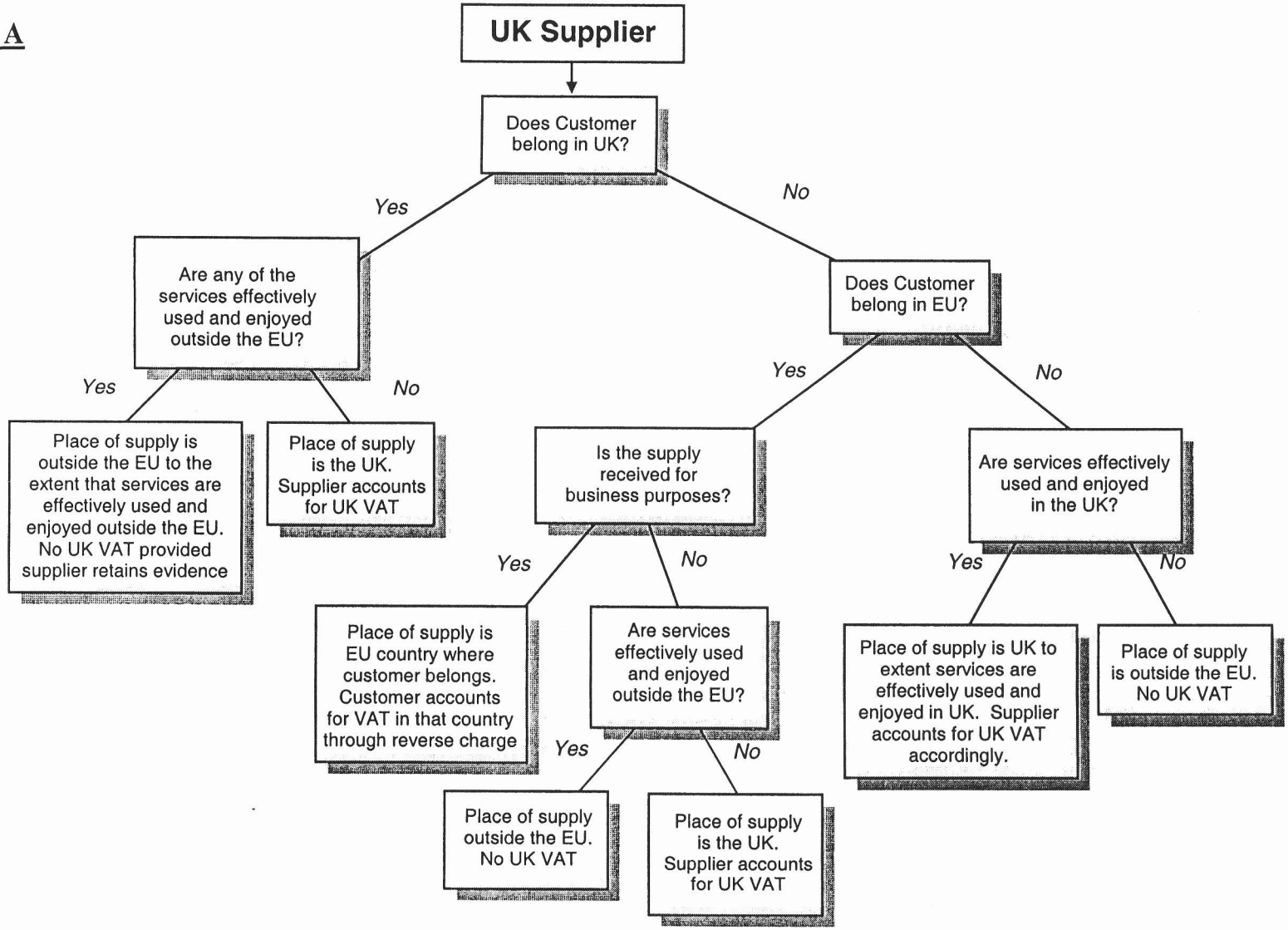
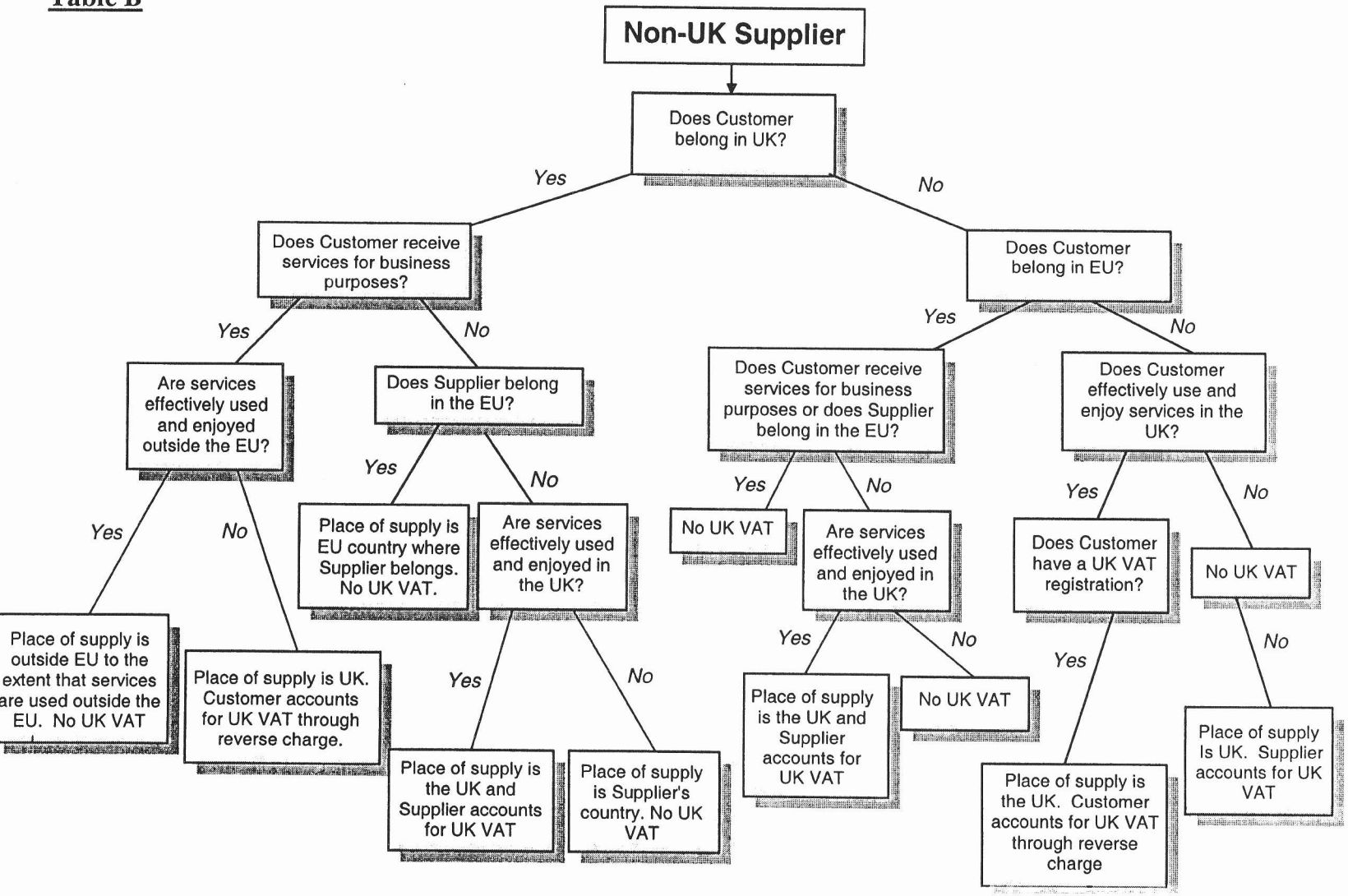

UK Supplier
Does Customer belong in UK?
Yes
No
Are any of the services effectively used and enjoyed outside the EU?
Does Customer belong in EU?
Yes
No
Yes
No
Place of supply is outside the EU to the extent that services are effectively used and enjoyed outside the EU. No UK VAT provided supplier retains evidence
Place of supply is the UK. Supplier accounts for UK VAT
Is the supply received for business purposes?
Are services effectively used and enjoyed in the UK?
Yes
No
Yes
No
Place of supply is EU country where customer belongs. Customer accounts for VAT in that country through reverse charge
Are services effectively used and enjoyed outside the EU?
Place of supply is UK to extent services are effectively used and enjoyed in UK. Supplier accounts for UK VAT accordingly.
Place of supply is outside the EU. No UK VAT
Yes
No
Place of supply outside the EU. No UK VAT
Place of supply is the UK. Supplier accounts for UK VAT

Table B


Non-UK Supplier
Does Customer belong in UK?
Yes
No
Does Customer receive services for business purposes?
Does Customer belong in EU?
Yes
No
Yes
No
Are services effectively used and enjoyed outside the EU?
Does Supplier belong in the EU?
Does Customer receive services for business purposes or does Supplier belong in the EU?
Does Customer effectively use and enjoy services in the UK?
Yes
No
Yes
No
Yes
No
Yes
No
Place of supply is outside EU to the extent that services are used outside the EU. No UK VAT
Place of supply is UK. Customer accounts for UK VAT through reverse charge.
Place of supply is EU country where Supplier belongs. No UK VAT.
Are services effectively used and enjoyed in the UK?
No UK VAT
Are services effectively used and enjoyed in the UK?
Does Customer have a UK VAT registration?
No UK VAT
Yes
No
Yes
No
Yes
No
Place of supply is the UK and Supplier accounts for UK VAT
Place of supply is Supplier's country. No UK VAT
Place of supply is the UK and Supplier accounts for UK VAT
No UK VAT
Place of supply is the UK. Customer accounts for UK VAT through reverse charge
Place of supply Is UK. Supplier accounts for UK VAT