

## **PRACTICE OF EUROPEAN COURT OF JUSTICE REGARDING VAT FOR AMERICAN COMPANIES**

**Kevin A. DIEHL**

Western Illinois University (US)  
Department of Accounting and Finance  
3300 River Drive  
Moline, IL 61265

### **ARE E-BOOKS AND AUDIO BOOKS SIMILAR TO PRINTED BOOKS FOR VAT PURPOSES? K OY**

K Oy, C-219/13 (2014), just decided before the European Court of Justice (ECJ), considers the highly important and timely issue of whether e-books and even audio books are the same as printed books for value-added tax (VAT) purposes. The ECJ found that, so long as the average consumer in each applicable EU country does not view them as similar, printed books can have lower VAT rates than e-books and audio books and not be in violation of EU principles of fiscal neutrality. This result remains effective even though e-books can be reduced to physical form as USB keys and audio books can be reduced to physical form as CDs and CD-ROMS.

#### **Procedural Background**

*K Oy* was before the ECJ on appeal from the Finnish Central Tax Board. This lower judicial body had ruled that the reduced VAT rate for printed books did not apply to non-paper-based books, such as e-books or audio books.

The ECJ had to address the issue under the first subparagraph of Article 98(2) and 6 of Annex III to Council Directive 2006/112/EC as amended under 2009/47/EC.

#### **Relevant EU Legal Provisions**

Article 96 requires national laws to have the same VAT rates for goods and services. However, Article 98(1) and (2) permit one or two reduced tax rates but only as permitted in Annex III, which included printed books, with reduced rates explicitly not applicable to electronically provided services. 4 of Council Directive 2009/47/EC updated books for technical progress. However, 6 of the same directive mentioned only books of physical means.

#### **Relevant Finnish Legal Provisions**

The normal Finnish VAT rate is 23 percent with the reduced rate of 9 percent on books. Finnish law mentions that books must be printed to get the reduced rate.

K Oy's Argument

The appellant believed different rates for physical books compared to audio books and e-books violates fiscal neutrality principles. Fiscal neutrality bars similar goods or services from having different VAT rates applied to them.

### **ECJ's Fiscal Neutrality Test**

Determining whether goods or services are similar requires consideration from the point of view of the average consumer located in each respective EU country. Similarity means that any differences would not be significant influences on consumers' choices. Significance is judged on the grounds of comparability in each EU country.

### **Conclusion**

Again, so long as the average consumer in the respective country does not consider the products as similar, printed books can have reduced VAT rates with regular rates applying to e-books and audio books.

### **Implications**

1. The ECJ has advanced an essentially facts and circumstances test in the area of reduced VAT rates, meaning continuing uncertainty in seeking equitable treatment of similar goods and services.
2. The facts and circumstances test could cause more countries to reverse their decisions to have lower VAT rates on some goods and services for fear of continued litigation in this area.
3. To secure the reduced rate, lobbying now becomes more important than reliance on equal treatment under the law, the principle of fiscal neutrality.
4. Regardless of the documented legislative intent behind the amendments to the relevant VAT provisions, the plain text of the amendment regarding technical updates seemed to suggest e-books and audio books were, after 2009, to be considered as books. Thus, legislative action seems likely in the aftermath of this ruling.

## **ARE EXTERNALLY SOURCED SERVICES THAT US COMPANIES PROVIDING TO EU BRANCHES SUBJECT TO VAT? SKANDIA AMERICA CORP. (SKANDIA SVERIGE) V. SKATTEVERKET**

### **Introduction**

In *Skandia America Corp. (Skandia Sverige) v. Skatteverket* (the Swedish taxing authorities), C-7/13, the European Court of Justice (ECJ) found that externally purchased services provided from US companies to their EU branches in exchange for consideration are subject to value added-tax (VAT) to the extent the branch is part of any VAT group that could be deemed to be the single taxable person. The VAT group itself would be subject to the VAT.

### **Procedural Grounds**

The Swedish tax authorities charged VAT on Skandia America Corp.'s services to its branch located in Sweden, Skandia Sverige. The Stockholm Administrative Court stayed

proceedings for Skandia America Corp. to bring this case before the ECJ for some preliminary ruling on this decision.

### **EU Principles**

The case required consideration of Council Directive Articles 2(1)(c), 9(1), 11, 56(1), 193, and 196 2006/112/EC. Whereas Article 2(1)(c) explains that any taxable person supplying services for consideration can be subject to VAT, Article 9(1) defines the taxable person subject to this VAT as any person carrying out “economic activity.” Article 11 further clarifies taxable person and permits any measures necessary to ensure evasion or avoidance.

Article 56(1) establishes the definition of where service delivery occurs. Namely, the place of supply is the location of the customer’s business or “fixed establishment” where the service is provided. If such location is not identifiable, the answer then is the location of the customer’s “permanent address” or typical residence.

Article 56(1)(c) mentions the relevant services in this case (consultants, engineers, lawyers, accountants, data processing, provision of information, etc.) as falling under Article 56(1)’s guidance, and Article 56(1)(k) extends this service definition to include beyond in person to “electronically” provided services, such as hosting online sites, distance maintenance of programs, and provision of computer applications.

Article 193 simply refers the reader here to Article 196 to determine the taxable person as Article 196 contains the relevant exception. This article identifies the branch receiving the services as the taxable person for fulfilling the VAT payment where the provider is outside the EU.

### **Relevant Facts**

Skandia America Corp. purchased outsourced IT services for the entire Skandia group and operated in Sweden through Skandia Sverige, its branch. Skandia Sverige had been registered as part of this VAT group. Skandia Sverige further processed the outsourced services that were then shared with the rest of the Skandia group inside and outside the VAT group. The internal profit margin was five percent with costs allocated to Skandia America Corp. and Skandia Sverige.

### **Ruling Considerations**

The ECJ had to test whether the branch was able to act on its own. First, it looked at whether the entity bore economic risk from its own business activities. Because, as the branch then, Skandia Sverige could not have its own capital or assets, it could not operate and bear economic risk on its own. Thus, it could not be the taxable person under Article 9.

Second, the ECJ consider the cost-sharing agreement. However, it decided the agreement to be irrelevant as the parties were related.

Finally, the ECJ relied on the initial VAT registration to sort out the matter. Skandia Sverige was part of this Skandia VAT group. Indeed, it had registered for the VAT as part of that group, so the services were considered to be supplied to the entire VAT group, not just Skandia Sverige. Therein, the transactions were taxable under VAT.

### **Implications**

1. To begin, US companies with operations in the EU should evaluate their EU entities' initial VAT registrations to know what entities is part of the VAT group.
2. While it was not necessarily part of the decision, US companies operating in the EU should consider insourcing in each country of operation rather than outsourcing potentially to avert these VAT consequences.
3. Under the previous consideration, US companies have to increase their emphasis on balancing income tax and VAT considerations in their internal invoicing procedures. Skandia America Corp. perhaps was too emphatic on income tax minimization to the detriment of the VAT results.
4. Finally, US companies should use this opportunity to evaluate the best entry points to selling to and operating in the EU.