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TERRITORIALITY AND VAT MECHANISMS

TOWARDS THE STANDARDIZATION OF THE TREATMENT OF SUPPLY OF GOODS AND SERVICES

- *English Summary* -

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SUMMARY

The work aims at analyzing VAT taxable transactions' territorial scope, with particular reference to the evolution of the connecting factors in application of which the place of taxation is determinated.

The analysis is carried out on differences in treatment of the two categories of supply of goods and provision of services, which are bound to an increasing convergence of discipline.

The research ranges from the identification of transactions that are relevant in VAT system and aims at drawing a parallel between territoriality and tax enforcement mechanisms, to conclude that a progressive harmonization of the provisions of law is in place: not only referring to the place of taxation of cross-border transactions but also with regard to the way to determine the amount and to pay VAT.

In the first chapter we outline the concepts of "*supply of goods*" and "*supply of services*": this shows a misalignment between EU law and national transposition.

According to VAT directives, "*supply of goods*" means the transfer of the right to dispose of tangible property as owner, while "*supply of services*" means any transaction which does not constitute a supply of goods. The system outlined by Italian law (D.P.R. n. 633/1972), on the contrary, includes into the area of "*supply of goods*" the transfer of property of all kinds of goods, also giving importance to the transfer of the legal (and not economic) availability of the asset; moreover, the category of "*supply of services*" is not found differentiating from the definition of "*supply of goods*" but get its own definition. As a consequence, a sharp contrast between the supply of "*goods*"

and "*services*" is drawn, so that national legislature needed to proceed to clarifications of the relationship between the two categories, for instance for intangible assets (naturally included in the area of services in UE law), in order to avoid contradictions which should be solved applying self-executing UE provisions.

The work seeks to highlight the importance of the transactions' classification which is determinant to draw the line between what is relevant to the tax system and what it is not but also to define the tax regime applicable.

For national transactions the distinction between "*supply of goods*" and "*supply of services*" impacts on some specific aspects of the discipline, specifically related to the time of the transaction; in the case of cross-border exchanges, instead, setting a qualification as *good* or *service* affects where the operation is done (which changes depending on the local level involved – EU or non-EU) as the mechanism of application of the tax (deduction/VAT refunds or reverse charge).

This aspect needs to be focus considering that the system is based not only on the identification of which acts or facts assume relevance for the purposes of the tax but also on the capability to make a "correct" (that means shared) qualification. This is important especially with regard to the need to eliminate factors which may distort condition of competition between Member States – in which the symmetries of the system are particularly acute – and that is also declined in a uniform interpretation of the locutions "*supply of goods*" and "*supply of services*".

Moving from these preliminary observations the work traces VAT territorial discipline, which is examined considering the dichotomy "*transactions involving goods – transactions involving services*" that characterizes the tax system.

The idea to look at "VAT territorial aspects" comes from the approval of Directive 12 February 2008 n. 2008/8/EC by the Council of the European Union, in which Community Institutions have created the so called "*reform of services*". Legislator set out a new territorial discipline distinguishing between services rendered to taxable persons (business to business) and to private consumers (business to consumer), differentiation through which can be seen the objectives pursued with the regulatory changes: to modernize and simplify how the common system of VAT works.

This scheme introduces two separate "basic rules" to recognize the location of the transaction (in place of establishment of the customer in the case of BtoB services and where is the service provider in the case of BtoC services) and accepts even for the services – as a clear change from the past – the principle of taxation at destination so far restricted to trade in goods.

It therefore seemed interesting to investigate the reasons that drove the choices made at European level, defining the framework within which these decisions have matured (in Chapter II), to go further to the perspective in which these rules have to be interpreted (Chapter IV).

Thus, first the discipline prior to the Directive n. 2008/8/EC has been analyzed, trying to point out – in addition to

describing the range and the changes that occurred in the criteria to define where the service is supplied – the link that marks the choices about territorial rules and implementation of the tax.

From the first point of view, intrinsic internal consistency of the rules on the location of supplies of goods has emerged, which is based in the solution of anchoring the place of taxation to the physical existence of the good in a certain territory as well as its movement within the Union or beyond its borders. Otherwise, the investigation about the performance of services showed the difficulties in finding suitable location criteria able to ensure the realization of the economic basis of the tax (the taxation of consumption in the country in which it is realized); complexity first led to the identification of the conventional place of consumption where the supplier is established (reasonable in an economy such as that of the 70s in which the transnational nature of the services was not a very widespread phenomenon) to turn gradually towards the residual of this criterion under the guidance of special different rules for certain sectors.

Moving to the second aspect however, it is highlighted the original mechanism to apply VAT get into crisis in all cases in which, as a consequence of the adoption of the destination principle, the burden of declaration, liquidation and payment of the tax is imposed on the economic operator which is not established in the country of taxation. The structure debit/deduction cannot function between Member States without the implementation of a cross-border deduction mechanism politically still not achievable. As a consequence, the UE law provided a special intra-UE acquisition of good regime (introduced by the Directive n. 91/680/EEC) and

accorded to the Member States the faculty to grant, in cases of transnationality, the quality of "*person liable to pay*" to the recipient of goods or services (when an economic entity itself).

A new system based on the symmetry of non-taxation / taxation has been therefore introduced, which characterizes both cases reported and expands its application with the Directive n. 2008/8/EC.

Our observations on this subject are contained in Chapter III where the new (EU and domestic) provisions are analyzed in terms of places of supply and choices on persons liable for payment.

The amendments introduced to the territorial aspect of the services – which now make them taxable at the place of establishment of the customer for transactions BtoB – were in fact accompanied by the choice of a general application of the reverse charge.

The progressive evolution of VAT territoriality marks a deeper change in tax structure, which changes due to the exceptions to the multistage mechanism trough a single-phase model.

In VAT, territoriality is a consequence not only of the object you want to tax (final consumption) but also a tool for the distribution of the revenues between Member States.

In other terms, territoriality plays a key role in the special relationship that exists between legal structure and economic aim of the tax, and represents one of the profiles that more clearly shows the tension between ideal and actual construction of the tribute.

In the original intentions of the Community institutions the ideal structure of VAT is modelled on the origin taxation principle for all goods and services: goods in this way absolve taxes in the country of the production process, regardless of the destination or the consumer market which are addressed. Following this scheme can be achieved an internal market between the Member States characterized by the absolute fiscal irrelevance of the cross-border nature of the transactions.

The lack of harmonization of national legislations, with specific reference to the applicable tax rates, however, avoided the creation of a tax model of the outlined type, leading rather to maintain the so-called "virtual" tax borders and the preservation of the destination taxation principle in all cases of possible market's distortion.

The study of Directive n. 2008/8/EC has allowed us to see how the adoption of a tax system based on the source taxation principle, which would represent the result of progressive harmonization of national VAT laws, is destined to be abandoned.

According to the Commission Communication COM (2011) 851 of 6 December 2011, known as the *White Paper on the future of VAT*, the implementation of the principle of taxation at the origin remains politically not achievable. The Commission expresses the will to orient its efforts on the development of alternative concepts for a VAT system based on the principle of destination that works effectively.

The guidelines for the future of the common system are placed at the end of this work, making them appear fully consistent with the schemes drawn.

Chapter IV summarizes the European Commission's attempts to implement the principle of taxation at the source that inspired the model of value added tax when it was set out. Subsequently, the perspectives emerging from the White Paper are described.

Thus, two significant documents are quoted: first, the *Program for the Common Market*, COM (96) 328, which outlines the design of a macroeconomic mechanism of compensation between States based on statistical indicators that would have allowed the equal treatment between intra-CE and national transactions; second, the *Communication on measures to change the VAT system to fight fraud*, COM (2008) 109, which instead lays ahead the possibility of building taxation at origin by the application of a single minimum tax rate and a microeconomic bilateral compensation system.

Chapter IV also describes briefly the one-stop shop mechanism introduced by Directive on electronic commerce and now extended to telecommunications and broadcasting services provided to consumers by operators in the Community.

Studies prepared by the Commission on these issues enable us to understand the transition from a model of origin-based taxation, based on compensation mechanisms between States, to the gradual awareness that destination principle is the only possible taxation within economic operators. In the *White Paper* this concept is definitely affirmed. The principle of origin taxation may in fact remain only for those goods and services that are supplied to final consumers with some exceptions in cases of localization criteria of the services in a different place from the State where the committee is established. Considering that the reverse charge is not

applicable in the relations BtoC, it needs other tools of simplification in order to implement tax in cross-border transactions.

In the White Paper the Commission undertakes detailed technical studies and the task to develop a broad dialogue with Member States and stakeholders in order to examine in detail the various methods of application of the destination principle.

It is interesting to observe that businesses stakeholders and the European Parliament have called for the concept of taxation at the place of establishment of the customer to be explored further. This would ensure that supplies of goods and services are treated in the same way. Decoupling taxation rules from the physical flow of the goods, while connecting them to the contractual flow, seems like a promising approach that deserves further examination.

This approach seems absolutely original because it undermines the model of territoriality for the supply of goods, based on the ability to follow the physical movements, to bring it closer to the choices made for the supply of services.

It seems to be difficult that such a way of taxation can meet the support of the Member States, but it shows the importance that the choices in terms of territoriality play in the tax system and the attention that the institutions put in the adoption of solutions balancing opposite requirements such as compliance to VAT and fraud fighting.