



## European Union:

# How the EU's Value-Added Tax (VAT) Impacts U.S. exports -Updated 2013

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November 2013

MR #161

## Summary

This report provides an overview of the EU's [Value Added Tax \(VAT\) rules](#) and how these rules impact U.S. exporters of goods and services to the EU. VAT is a complex area consisting of many rules and exceptions. While the guidelines for VAT policy are set at the EU level, the Member States implement, administer and enforce the rules. Therefore, VAT rates differ in each Member State, and currently vary between 15% and 25%. Member States, at their discretion, may apply reduced rates for specific goods and services, or even temporary derogations. This report focuses on the basic set of principles that will help U.S. companies understand and navigate the VAT system.

## Introduction

VAT obligations for U.S. companies involving business transactions can vary according to the following criteria:

- From where the U.S. company is operating;
- Where a company's final customers are based;
- Whether a particular customer is a business or a consumer; and
- Whether services or goods are being supplied by the original company.

In the EU's VAT language, applying VAT is relevant only to "taxable persons." A "taxable person" is described as any individual, partnership, or *company that supplies taxable goods and services in the course of business*. Thus "taxable persons," where stated in this report, refers to these categorizations of individuals/entities that are involved in economic activity.

The most important pieces of legislation on VAT are the [EU VAT Directive 2006/112/EC](#) and its [Implementing Regulation 282/2011](#). See the last section for additional legislative developments.

## Topics in this report:

- Section I: Overview of the VAT system and how it works;
- Section II: How VAT impacts U.S. companies supplying goods to the EU or within its borders;
- Section III: Rules for providing services to EU customers;
- Section IV: Specific VAT rules applicable when supplying ESS (Electronically Supplied Services);
- Section V: Business activities that may qualify for a VAT refund;
- Section VI: Useful web links.

## I. What is the VAT? How does VAT work? And who pays for VAT?

The VAT is a tax on consumer spending that is collected by VAT registered traders on sales of goods and services. The premise behind the VAT is that a tax on the “value added” is imposed at each stage of the production and sales process of a good; it is the final consumer – at the end of this process – who absorbs the tax as part of the total purchase price. “VAT is charged when VAT-registered (taxable) businesses sell to other businesses (B2B) or to the final consumer (B2C). VAT is intended to be ‘neutral’ in that businesses are able to reclaim any VAT that they pay on goods or services. Ultimately, the final consumer should be the only one who is actually taxed. Businesses operating in the EU are given a VAT identification number and have to show the VAT charged to customers on the invoices.”<sup>1</sup>

Please note: Not all goods and services are subject to VAT. For a list of exemptions, consult Title IX of the [VAT Directive](#).

### a) Taxing Process

Companies need to pay out VAT on business inputs before being able to recover it through their VAT returns. VAT is charged when a VAT registered business sells to either another business (a “taxable person”) or non-business customer (a “non-taxable person”). There are two forms of VAT relevant to business transactions: *Output* and *Input* VAT. Each participant in the supply chain – from manufacturer to retailer, through wholesaler and distributor – charges VAT on the sales it makes. This is labeled *Output VAT*. When a trader pays VAT on its purchases, this is referred to as *Input VAT*. Traders take what VAT they have received and compare it to the VAT they have paid out themselves and then submit the surplus to the appropriate VAT authority. If their total VAT payments (input VAT) surpass their total VAT receipts (output VAT), then the entity receives the difference.

When a VAT registered business buys goods or services, it can generally reclaim the VAT it has paid. Please note that if an entity is not a VAT registered business, it may not reclaim VAT that it has paid on goods and services. One must establish its business as a “VAT-registered business” if it sells VAT-taxable goods and/or services and its turnover for a 12-month period reaches or exceeds a certain financial threshold. To consult with a particular tax authority in a Member State country where one wishes to do business, consult the list [here](#). (See the VAT refund section below).

### b) VAT Rates

The EU’s VAT system is semi-harmonized. While the guidelines are set out at the EU level, the implementation of VAT policy is the prerogative of Member States. The EU VAT Directive allows Member States to apply a minimum 15% VAT rate and a maximum of 25%. However, they may apply reduced rates for specific goods and services or temporary derogations. Therefore, the examination of VAT rates by Member State is strongly recommended. These and other rules are laid out in the [VAT Directive](#).

The best sources for navigating the VAT process are the following websites of the European Commission:

- [Basic information on the application of VAT in the Member States](#)
- [An updated list of the Member States’ VAT rates](#)
- [Table of the derogations](#)
- [A List of the Member States’ VAT authorities](#)

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<sup>1</sup> “Questions and Answers: Value Added Tax,” European Commission Memo 11/874, 6 December 2011.

For more information on VAT rules, consult the EU's [VAT webpage](#), its [webpage on the place of taxation](#), and the [EU's VAT Committee guidelines](#). Please keep in mind that the VAT Committee guidelines are not legally binding and can therefore be challenged by Member States.

## II. How does VAT impact a U.S. company's supply of goods and what is its VAT obligation?

VAT is applied at the *place of supply* of a good or service (meaning where the good is sold or provided to the end user). Therefore, VAT is relevant when the *place of supply* is in the EU, as this determines the VAT rate to be applied to the transaction. Regarding cross-border sales between a business and another business (between EU states), the VAT is calculated and collected in the Member State where the final sale of the good (or *service*, discussed below) takes place. The VAT for goods (and services) provided from a business to a *customer* is paid by a supplier in the Member State where the sale occurs or where the supplier is established.

It is important to note, however, is that this “place of supply” principle *does not always* determine whether it is the supplier or the customer who is liable to pay the VAT to the tax authorities. A supplier's VAT registration and collection responsibilities depend on several variables, the most important of which are:

- Where the supplier is based;
- Where the customers of the supplier are based;
- Whether the supplier's customer is a private consumer or a business; and
- Whether services or goods are being supplied by the company

The following sub-sections present VAT scenarios that a typical U.S. exporter and business might face.

### a) The importation of goods from the U.S. to the EU

U.S. Goods imported into the EU will be taxed at their point of entry into the Member State where they are cleared. There is no central EU VAT rate; therefore the taxation rate is subject to the Member State where the goods enter. (See above: VAT rates)

However, there is an exception to this rule. If the goods are placed under a “suspensive customs procedure” (which is considered an “in-transit” procedure) when they enter the European Union, the VAT rate on the imports will be representative of the Member State where the goods finally rest.

The VAT rate on imports is calculated based on the value of the goods plus any customs duty. The person or firm responsible for paying this VAT rate is called the *importer of record*. If the U.S.-based exporter is listed as the *importer of record*, then the U.S.-company takes on all responsibilities associated with the VAT. However, in most “**business to business**” transactions (B2B), the *importer of record* is the business customer located within the European Union.

This means that, in general, the U.S.-based supplier does not need to register for VAT or collect tax on the sale. However, for some Member States, the U.S.-based company is indeed required to register for VAT, regardless of their role in the transaction (eg. the United Kingdom established such an obligation since December 2012). To determine whether the Member State you wish to do business in requires U.S. Companies to register for VAT, please consult the respective Member State's VAT or taxation websites [here](#).

## b) VAT on the cross-border supply of U.S. goods within the EU (Intra-EU movement)

As just discussed, an import tax must almost always be paid when a U.S.-produced good arrives in the EU. Once a product has been imported into one particular Member State, VAT is subsequently applied to its onward supply to customers in other Member States. Determining the place of taxation depends, according to the VAT legislation, on where the *acquisition* of goods legally takes place, usually the final destination.

For goods traveling to customers in other countries (beyond the import country), the supplier of the goods does not have to pay VAT on the transaction *if* the end business customer has a registered VAT number that is then attached to the invoice. The customer applies the local VAT rate using the *reverse charge* procedure, meaning that the business customer here, for VAT purposes, acts as both the supplier and the recipient. This intra-EU transaction is called an *acquisition*.

If a U.S. business/producer is selling goods within the EU directly to (non-business) consumers the *rule of distance selling threshold* is applied. For instance, a U.S. company operating its EU base out of the UK will charge UK VAT on its sales of products to consumers in other Member states unless its total value of sales to one of those Member States goes above a *distance selling threshold*. [Thresholds vary for each Member State](#). U.S. companies need to register for VAT in each Member State where the threshold is breached. The *threshold* only applies to goods sent from a VAT registered business in one EU Member State to a consumer in another.

U.S. companies can arrange for an EU-based agent, registered for VAT purposes, to import and supply goods on their behalf. The agent will be considered the *principal* for VAT purposes. The *principal* would make any necessary customs entries as the importer, pay or defer the VAT, and take delivery of the goods.

When a U.S. exporter uses a *principal* (also known as an *importer of record*) to handle the import procedures, this import agent would normally then complete the import declarations. In this case, the import agent is referred to as the “Importer of Record” and pays the customs authorities the appropriate import VAT. Because the goods imported are not for the purpose of the *agent’s* business, they cannot reclaim what they paid in VAT as an input tax. Thus, they would normally include the import VAT amount it paid in its invoice to the U.S.-based exporter. U.S. companies often pay this VAT as part of the total fee to the shipper/forwarder in the EU. However, if the U.S. company registers itself as the *importer of record* and is therefore “registered” for VAT, then it can reclaim this import VAT.

## III. VAT rules on the supply of services to EU customers

The identification of the place of supply for services is subject to more complex rules than for goods. The EU’s VAT law considers everything that is not a good (generally a tangible property) as a service. Services can include everything from the licensing for intellectual property to downloadable software to consulting – to name but a few examples.

As of January 1, 2010 VAT on services should be applicable at the rate where the supply takes place. However, this does not always mean that U.S.-based suppliers need to register for VAT and include VAT in their prices. In many cases, the business customer will account for VAT using the *reverse charge procedure*. Under certain circumstances depending on each Member State, *registration* for VAT purposes is necessary. This may occur when the buyer is a non-business customer not registered for VAT purposes. For example, radio and television broadcasting services are governed by specific EU rules requiring non-EU suppliers to register in the Member State where they are providing the service to non-business customers.

Where a U.S. producer needs to pay VAT and at what rate depends not only on the type of service that is provided, but also what the status of the customer that is receiving the service. This is either a taxable person (which is a business customer acting in an economic capacity) or a non-taxable person (the final consumer who is not carrying out any further activity).

VAT requirements for services depend on the end customer:

- For a taxable person (a Business-to-Business relationship), the supply of service is taxed where the customer is established;
- For a non-taxable service (a Business-to-private individual customer relationship), the supply of service is taxed where the supplier of the service is established.

#### **IV. Specific VAT rules on Electronically Supplied Services (ESS) to EU non-business customers** **([Article 58](#) of VAT Directive)**

Since 2003, the EU has applied VAT to sales by non-EU based companies of electronically supplied services (EES) to EU-based individuals (non-business customers). U.S. companies impacted by the changes of rules must collect and submit VAT to tax authorities within the Member States. Therefore, this report provides an overview of [ESS and the application of VAT to ESS](#), the companies impacted by the change, their compliance, and how they can fulfill these obligations.

##### **a) What is an electronically supplied service?**

[Annex L](#) of the Directive addressing the taxation of ESS gives an illustrative, but non-exhaustive, list of the types of supplies that can be considered ESS (i.e. web hosting, distance teaching, software supply, movies, information). In addition, the [EU's VAT Committee](#) (which is composed of Member States' VAT officials and is chaired by the European Commission) has issued [guidelines to clarify and finesse the list](#). Again, please keep in mind that this committee's work is not legally binding and can therefore be challenged by Member States. This VAT Committee has identified additional categories to list under ESS, such as online auction services (online market places and online shopping portals) and internet service packages (such as content pages containing news or travel information and access to chat lines). Their guidelines also suggest a two-step test to assess whether a given supply can be considered an ESS: "An ESS should be reliant on the Internet or similar network for its provision" and "be essentially automated, involving minimal human intervention." Therefore, where an electronic network such as the Internet is used simply as a means of communication in much the same manner as a telephone or fax machine, the service provided might not be considered an ESS because the service relies on substantial human intervention.

## b) Taxation obligations of ESS

Article 58 of the VAT Directive places VAT requirements on U.S.-based suppliers of ESS to non-business customers (non-taxable persons), where earlier this was not required. The provision states that any ESS provided by a non-EU country to non-taxable persons in an EU country must be taxed at the place where the customer has a permanent address or currently is residing at the time of the provided service. Sales made to business customers require the importing company to pay the VAT under the *reverse charge procedure*. A current listing of the VAT rates for ESS in the individual Member States as well as their respective information websites can be found on the [FAQ page](#). All VAT-registered U.S. companies would file VAT receipts to EU-based VAT authorities thereafter. For more information, consult the European Commission's website on [VAT rules for ESS](#). The following website [UK's HM Revenue and Customs FAQ document](#) has additional information.

Companies need to identify whether their consumers are business or non-business customers and where they are located, since the VAT rates differ among Member States. The [EU's VAT Information Exchange System \(VIES\)](#), listing VAT-registered companies, can help find such information. Concerning the location of the customer, the VAT rate is calculated on the basis of a customer's declaration, potentially verifiable against a credit card billing address or by geo-locating tools. For more information on the functioning of the VIES, please click [here](#).

## c) Options for U.S. Exporters on dealing with ESS

Companies impacted by VAT rules have several options to achieve compliance. This report does not make any endorsements or recommendations, but presents the following options for U.S. businesses:

- **Set up a permanent establishment in one of the 28 EU Member States** and apply the rate of VAT applicable in that Member State to all their ESS sales to customers within the EU
- **Register for VAT in each Member State where they make sales to non-business customers** and collect VAT at the rate applicable in those Member States, therefore making separate returns to each national VAT authority (this option is usually preferred).
- **Use the Directive's [Special Scheme](#)** that allows companies to register towards a single VAT authority of their choice and charge a different VAT rate depending on where their customers are based. In this case, VAT returns are submitted to a single authority.
- **Sell ESS through local EU-based distributors** by redirecting potential customers to their websites. The distributor would apply the local rate of VAT applicable in its country and handle VAT administration with the local authorities.
- **Outsource electronic transactions to an E-commerce Service Provider** including VAT collection and administration, among other services.

## d) New Practical Guidelines for Businesses

The Commission published practical guidelines to prepare businesses for the new VAT rules for telecom and e-services, which will enter into force in February 2015. The aim is to help businesses be fully prepared for the change-over, whereby VAT will be charged based on the location of the customer, rather than that of the seller. [A One Stop Shop](#) will enable telecom, broadcasting and e-services businesses to comply with all of their VAT obligations in all Member States from their country of registration. These new guidelines focus on the required

information to register and account for VAT, as well as its format, submission deadlines, and practical details on payments. Additional guidelines will be published in 2014 on new supply rules.

VAT on electronic devices:

[http://ec.europa.eu/taxation\\_customs/taxation/vat/traders/e-commerce/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/vat/traders/e-commerce/index_en.htm)

More details on the 2015 VAT change and the One Stop Shop:

[http://ec.europa.eu/taxation\\_customs/taxation/vat/how\\_vat\\_works/telecom/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/vat/how_vat_works/telecom/index_en.htm)

[http://ec.europa.eu/taxation\\_customs/resources/documents/taxation/vat/how\\_vat\\_works/telecom/one-stop-shop-guidelines\\_en.pdf](http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/telecom/one-stop-shop-guidelines_en.pdf)

## V. VAT Refunds

A taxable person (thus a business conducting economic activity in the supply of goods or services) has various options. (1) It can deduct VAT that was made on purchases if the goods and services are used for economic activity. If not, then such a business cannot apply for a VAT deduction. (2) As mentioned in the beginning of this report there is also an opportunity to receive a VAT refund if a taxable person's *input VAT* exceeds its *output VAT*. The refund is the excess that was paid. However, checking this policy on a country by country basis is recommended because some Member States allow the excess VAT paid to be carried over into the next taxable period to offset any proceeding taxation that may be due by a company. Links to the VAT refund procedures in the Member States are on the EC website on [VAT refunds](#). (3) U.S.-based companies with no subsidiary in the EU must pay VAT related to their business dealings in a Member State *where they do not supply goods or services* but have a right to a refund in the Member State where the VAT was incurred.

Please note: "A taxable person does not have the right to a VAT refund if the business conducted does not require charging VAT on its outputs (such as schools, banks, insurance companies, and small businesses under the exemption threshold). There is also no right to a refund if the activities of a business are used for an 'exempt activity.'"<sup>2</sup>

In October 2013, the European Commission unveiled a draft Directive to introduce a standardized VAT return process in the European Union by 2017. The purpose is to replace the 28 Member States' versions currently in use, thus ensuring companies provide the same basic information within the same deadlines across the EU, irrespective of the Member State they file from. This should reduce red tape and administrative costs for the submission of company VAT returns. Along with the VAT identification number and the tax period, the new form (to be completed in the language of the person liable for VAT) would have only five boxes (VAT to be paid, deductible VAT, balance between VAT to be paid minus deductible VAT, total sales and total purchases). As the Proposal currently stands, Member States may, however, add up to 21 additional boxes. The new form will be much simpler than current returns, which range from 6 boxes in Ireland to 586 in Italy! Companies will have to submit VAT returns monthly, with the exception of enterprises with a turnover of less than €2 billion; they will need to submit quarterly. The requirement in some countries to make an annual summary of VAT would be scrapped. In 2014, the Draft Directive will be debated in the Council of Ministers and the European Parliament for amendments.

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<sup>2</sup> Information taken from: [http://ec.europa.eu/taxation\\_customs/taxation/vat/traders/vat\\_refunds/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/vat/traders/vat_refunds/index_en.htm)

## VI. Additional links

[VAT General Overview](#)

[EU'S VAT Committee](#)

[EU Member States' VAT Competent Authorities](#)

[UK's HM Revenue and Customs VAT website](#)

### For More Information

For more information on this topic, or for a copy of our related reports, please contact:

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