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Client Alert

May 2002

BUSINESS AND FINANCE

EU to Assess New Value-Added Taxes on E-Commerce with U.S. Businesses

The leaders of the European Union (EU) say it is an attempt to “level the playing field.”¹ U.S. critics of the law say it amounts to an unfair import tax, which in effect, makes EU digital exports cheaper.² In an action that is sure to fan the smoldering flames of the growing trade differences between the U.S. and the EU, the European Union ministers have approved new taxation rules that will require Internet companies to pay levies on EU-based sales of digitally downloadable goods and services. The new Value-added tax (VAT) regime will come into force on July 1, 2003.³

U.S.-based businesses should begin preparing now for the new compliance requirements, which threaten to be complex. The new taxes will apply to the following:

- cultural, artistic, sporting, scientific, educational, entertainment, or similar activities, and the “supply of ancillary services,” including all forms of broadcasting as well as other sound and images delivered by electronic means;
- software, including computer games;
- data processing, including services such as web-hosting, web design or similar services; and
- the supply of information, including subscription content services and Internet service providers.

The term “by electronic means” in the Directive does not include the delivery of electronic content in a tangible form, such as on CDs or DVDs.

Broadly speaking, the effects of the new rules for non-EU businesses will be as follows:

- Non-EU businesses which provide electronically-supplied services or broadcasting services to consumers will need to register for and charge VAT.

¹ “EU to tax e-commerce with U.S.,” *Reuters*, May 6, 2002.

² “EU digital goods tax worries U.S. firms,” *electricnews.net*, Feb. 11, 2002.

³ Regulation of the European Parliament and of the Council amending Regulation (EEC) No 218/92 on administrative cooperation in the field of indirect taxation (VAT), 2000/0147 (COD), 2000/0148 (CNS).

- Non-EU businesses will be required to register in one of the 15 member states of the EU,⁴ but will be free to choose which one.
- Non-EU businesses will be required to charge VAT to *consumers* at the standard rate charged by the member state in which the *customer is resident*.
- It appears that the non-EU business will have to pay up to 15 different amounts of VAT and file a “15-line VAT return” with the tax authorities in the member state in which it registers. The tax authorities will then distribute the VAT to each other country where customers have made purchases.
- Registration will not be necessary for non-EU businesses with an annual level of sales *within the EU* of less than 100,000 euros (approximately \$90,912 at May 7, 2002).

A different method applies to non-EU businesses providing such electronic services to other *business* customers — so-called B2B services.

A “business” customer in the EU would be one that is registered with a VAT authority and has a VAT number. Businesses in the EU are already required to “reverse charge” or “self-assess” VAT on business products and services. The new Directive extends the existing “reverse charge” rules to include electronic and broadcasting services.

U.S. businesses selling digital products over the Internet or providing subscription broadcast programming or other pay-per-view services will need to develop systems to (1) determine whether a customer is a business or a non-business customer (including verifying a business customer’s VAT number); (2) determine in which EU member state a non-business customer is resident; (3) determine which rate of VAT to charge; (4) collect the correct VAT and pay it to the relevant authorities; and (5) file VAT returns with the relevant authorities.

Of course, there will be penalties for non-compliance, including penalty and interest charges on all VAT liability. In some circumstances, unpaid VAT liability may pass to a subsequent purchaser of a business and sanctions under civil or criminal laws in individual EU member states may attach to the business and its officers and/or directors. Moreover, existing European Community laws in relation to taxation ensure that a tax debt in one member state is effectively enforceable anywhere in the EU.

If you would like more information on the impact of the new VAT regime on your business, either contact Cynthia Larose (clarose@mintz.com / 617 348 1732), or the Mintz Levin attorney who handles your legal matters.

⁴ Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom.