EU VAT changes on January 1st 2015 mean that businesses selling digitally-delivered services no longer charge VAT based on their home country. They must now charge VAT on every single non-home country EU sale at the rate applicable in the EU Member State where their customer is resident. The justification for the legislation was to prevent large companies from locating in low-VAT EU Member States to reduce their tax liability - a laudable aim.

This means, whereas before a business always knew where the sale had taken place and had to deal with perhaps 2-3 VAT rates, they now have to capture two pieces of non-conflicting evidence to prove where the customer lives and apply the correct rate out of the 81 the EU uses. It has brought the same complexity of administration and compliance to the board rooms of multinational corporations and the kitchen tables of sole traders. Administering the purchase process has been made massively more complex, with additional demands of calculations for VAT MOSS returns, data auditing and data protection compliance.

No allowances or variations were made in this multifaceted legislation to ease the burden on micro businesses. There was no attempt to assess the impact of this legislation on the smallest micro businesses and sole traders, because iIt was incorrectly assumed that they didn't sell direct through their websites or they didn't sell outside of their home country.

Two weeks into the changes, millions of the smallest businesses across the EU are faced with legislation so complex that they cannot comply with it and are faced with either breaking the law or closing their doors. The payment processing systems they use do not give them access to the required audit data to prove the location of their customer. Manual administration of the legislation, which is automated in a large company, wipes out their profit margin on low-priced digital products.

Consumer prices have risen. VAT is added where it previously wasn't applied and traders must now cover additional administrative costs or pay the high fees demanded by 3rd party reseller platforms in order to keep trading. Consumers also face reduced choice as thousands of companies refuse to sell outside of their EU Member State, drop digital products entirely, or as non-EU firms now block sales to EU consumers, damaging the business's profits and limiting their growth. Piracy is growing, as consumers illegally share files they cannot legitimately buy.

Micro businesses are ceasing to trade daily. They know they cannot comply with the legislation or cannot afford the administrative cost - financially and time-wise. And they are seeing sales fall by as much as 25%, due to the extra information they are having to request from customers during the purchase process. This affects hundreds of thousands of small digital traders in the UK alone.

Unfortunately it would be very difficult to revise this legislation: with 28 Member States and 81 VAT rates involved it will always be hugely complex - unjustifiably so for the smallest businesses. This does not mean action cannot be taken to mitigate these unintended and disastrous consequences.

Proposed Solution

1. Immediately suspend implementation of the rules for micro businesses, allowing them to revert to the previous home country VAT rules.

2. Lobby the EU Commission to introduce a worldwide derogation that gives micro businesses (under the EU definition) an exemption from this legislation, instead allowing their home country's previous VAT rules to apply.

Member States will still benefit from the positive intention behind the legislation as far as the small, medium and large companies are concerned. The small amounts lost from other Member States' Micro Businesses will be compensated for by the additional VAT they would gain from their home-grown Micro Businesses. VAT thresholds need not change. We are simply asking that the smallest businesses are allowed to keep trading under the old rules.

Background Information

On 1st January 2015 new EU VAT legislation came into force, for 'digitally delivered services' sold in the EU. Instead of businesses reaching their local turnover threshold applying VAT to B2C sales according to the country in which they are based, they must now apply VAT rates from the country where the Consumer is located. These rules were introduced to prevent large companies from channeling trade through low-tax EU Member States.

However the regulatory evidence requirements are the same for multi-billion Euro firms as for sub-€1000 Euro kitchen table sole traders. The impact on Micro Businesses was officially excluded from the EU & Member State Impact Assessments because it was incorrectly assumed that the smallest businesses either trade through 3rd party platforms or don't trade outside of their home country. In reality such businesses frequently sell direct from their own websites, across Europe and beyond, from the outset. This is how the Internet works in 2015.

The Legislation Hugely Disadvantages Micro Businesses

Large companies have complex websites, with high-tech shopping cart systems and dynamic web pages. They can tell the customer's location, show the correct price and track the required audit-trail evidence automatically. For them, this legislation was relatively straight-forward and they were given plenty of notice, enabling them to develop compliant systems.

Small companies typically run low-tech websites, with PayPal 'buy now' buttons or very simple shopping carts. None of these are compliant with the legislation, presenting small businesses with the following barriers to trade:

- They don't know which price to display to a consumer until the final stage of checkout.[1]
- Most micro businesses don't have access to the required audit data for proof of place of supply.[2]
- None of the current software fixes are fully compliant with the legislation, because they cannot accurately handle VAT rate complexity.[3]
- Manually creating approved VAT invoices for the countries that require them is an unreasonable administrative burden for low-margin sales.[4]
- Most of the 3rd party platforms, on whom the EU was relying, are not compliant with the rules. Some only heard about the legislation a month before it came into effect.[5]
- Consumer choice is falling and prices are going up.[6]
- Many USA firms are now refusing to sell to EU consumers.[7]
- Most micro businesses estimate that it will cost them an unreasonable proportion of their margin to handle the administration of this legislation.
- Most EU Member States are interpreting the definition of 'digitally-delivered service' differently, making it impossible to be compliant with all 28 States' rules.

We have already been contacted by 200+ UK companies who have closed down because they cannot comply with the legislation. We expect the real figure to be many times this. Many of these are sole traders who were selling craft patterns, e-books and many other skills and knowledge based products in order to stay off benefits. Some are larger businesses who simply cannot afford the cost of developing a running such a complex website and shopping cart system.

The UK Government Won't Get The Taxes It Was Promised

Very few EU Member States have publicised or enforced this legislation. They will be collecting very little revenue on our behalf. While the UK is damaging its home-grown micro businesses, to collect taxes on behalf of other EU Member States, HMRC will not receive the taxes hoped for in return.

What Is Needed

The EU Member States have implemented the legislation, fulfilling their legal obligations. However, due to the devastating unintended consequences for businesses never considered in impact assessments, the governments can and must immediately suspend implementation, pending a thorough impact assessment, negotiation of a sensible exemption threshold for micro businesses, and a ground-up reworking of the legislation to make it workable above the threshold.

Notes & Explanations:

1. Businesses either have to break Consumer Law by displaying the ex-VAT price on their website or apply a VAT 'fudge-factor' and work it out manually, for each and every transaction, after the sale. Bearing in mind that the margin on the digitally-delivered sales is typically extremely low (often under £2), the manual administration will quickly wipe out any profits. Any business insisting on customers identifying their home country before browsing their website will lose a huge proportion of visitors.

2. The legislation requires businesses to collect 2 pieces of non-contradictory data to evidence the place of supply. Most of the options on the 'approved' list are either unreliable (e.g. using the IP address gives the wrong country in at least 10% of transactions / customer-declared address can be faked to get a lower sales price) or completely unavailable to small businesses (e.g. customer bank address / landline or mobile number from which the service is purchased). Most micro businesses only have access to the customer's address as supplied by the payment processor. This is also unreliable. Our research indicates that nearly all consumers, if emailed by a digital seller and asked to confirm their phone number or address, would fear identity-theft and would not reply. More importantly, they would avoid that seller in future.

3. Most of the software 'fixes' we are seeing can only handle 1 VAT rate per country and don't apply this until the checkout. Selling an e-book and an online course to Italy, for example, involves 2 VAT rates in one transaction. Whether this is bundled or split, it adds to manual post-processing and could require businesses to have to refund any overpaid VAT to the customer. None of the micro business solutions found so far can apply the HMRC 'bundle' rules to a transaction.

4. Some EU states require the issuing of an approved VAT invoice to the consumer. Again, this would have to be done manually after the sale; an unjustifiable administrative burden on the sale of a 99p app or MP3 download or £2.99 e-book or craft pattern.

5. The rules are so complex that 3rd party platforms are having to completely re-write their shopping carts to comply. Many of these companies have few employees and minimal access to the high-tech reprogramming that their shopping carts would require. Most didn't even hear about the legislation until December 2014.

6. Consumer choice is falling. Many sellers now refuse to sell outside of their home Member State. Costs for consumers are shooting up as businesses have to apply VAT 'fudge factors' and increase prices to cover the extra administration. Those businesses attempting to comply are now becoming uncompetitive, compared to rivals who can either avoid the legislation or are simply ignoring it. Many more are still wholly unaware of the new legislation.

7. We are getting daily reports of USA firms now refusing to sell to EU consumers, to avoid the huge administrative burden of compliance. This reduces consumer choice. It is also damaging UK micro businesses. If they aren't VAT registered, they can't prove they are a B2B purchase. So they are now excluded by many USA companies, on whose products they rely. This is not just a European problem. These new rules are a worldwide problem.