VAT & Digital Gaming

In 1967, when the European Economic Community adopted the First VAT Directive, Mr Baer, 'The Father of Video Games', played the first video game on a home console – 'The Brown Box'. By the time the Sixth EU VAT Directive was issued in 1977, the entertainment industry had moved to the era of arcade video games with successful games on the market like Atari's 'Pong' and 'Break Out'. Since then, the gaming industry went online from home consoles to smartphones, tablets and smart TVs. In the meantime, tax authorities were discussing and legislating new provisions with the aim of ensuring that supplies, including electronic supplies, are VAT-taxed in the place of destination/consumption. Malta, whilst passively being affected by such EU and global VAT developments and by the technological advancements in the sector, has actively set Digital Gaming as one of its priority sectors for growth. With this vision in mind, successive governments have designed an ambience to attract, nurture and develop a cluster of high quality game companies through fiscal, educational and regulatory support.

Indeed, Digital Gaming is budding locally and with the growing number of game developers on our shores, the VAT implications of their operations is an aspect that is worth considering.

General VAT principles

With broadband, the traditional model of developing, publishing and delivering games has evolved into more complex online supply chains that stretch across borders and that involve new functions, like content aggregators, platforms, software libraries, online stores and game websites and new services such as suppliers of character animation technologies and new revenue streams, ranging from royalties, subscription fees, pay-per-play and premium rate service remunerations. In deciphering the VAT treatment of such transactions in a chain, the crux would be to find out **'who is doing what for how much and when and where are they doing it'.**

The Maltese VAT principles that may be relevant to the gaming sector are the following, in line with the EU principles;

VAT does not only apply to supplies of goods and services but also to transfers of intangibles such as software rights, brand-names and other IP.

In the absence of VAT grouping provisions in Malta, intra-group transactions are treated in the same way as transactions with third parties.

B2B supplies of services are generally subject to VAT in the country of establishment of the customer. Therefore cross-border supplies of services, including intangibles such as IP by Maltese suppliers to business customers generally fall beyond the scope of Malta's VAT net.

B2C supplies of services are generally subject to VAT in the Member State of establishment of the supplier. Such place would be Malta if the supplier is established herein. However, this rule does not apply if the services qualify as TBEs ('telecommunications, broadcasting or electronically supplied services') or if the services are provided to non-EU customers. In such cases, B2C supplies of services by suppliers in Malta would generally fall outside the scope of Maltese VAT.

VAT on the purchase of goods, such as computer equipment, from outside Malta is either collected by Customs at the point of importation from a non-EU country or accounted for on a 'reverse charge' basis in Malta by the recipient if the goods are acquired from another EU State.

The purchase of services from outside Malta, such as advertising and intangibles, is generally imposed on the recipient on a 'reverse charge' basis, unless the specific service would be covered by an exemption. Typical exempt services would be those provided by payment services providers.

Game developers, publishers, intermediaries and distributors should be in a position to recover input VAT on their expenses and thus, VAT should not be a real cost to such entities, but instead, an administrative compliance issue.

Transfers of business could qualify for VAT relief if certain conditions are satisfied. This could be useful when M&A and inorganic growth strategies are considered.

VAT on electronically supplied services across the EU

As we refer to 'electronically supplied services' (ESS) above, mention has to be made to the current VAT rules applicable to B2C supplies of ESS, which rules were significantly changed as from 1st January 2015.

For VAT purposes, ESS is a term referring to *'services which are delivered over the Internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention, and impossible to ensure in the absence of information technology.'* The non-exhaustive list of ESS laid down in the EU VAT Directive includes downloading of games on to computers and mobile phones and accessing automated online games which are dependent on the Internet, or other similar electronic networks, where players are geographically remote from one another.

In essence, supplies of ESS to private consumers are VAT-taxable in the country of consumption or residence of the consumer. Following this rule, for those suppliers who 'sell' or grant the right of use of games online to final consumers, establishing the jurisdiction wherein such consumers are located is imperative to enable the suppliers to correctly charge VAT in accordance with the rules of that country. IP address verification and geo-location tracking on their own are generally not sufficient and need to be backed up by other evidence of a player's place of residence.

The 2015 VAT rules have also introduced provisions that deem certain intermediaries in a chain of transactions, for example an app store, as the ones buying in and reselling the digitised product to private customers. Such deeming presumptions can be rebutted if certain conditions are fulfilled.

Bearing in mind the differing VAT rates and administrative rules within the EU, B2C suppliers of ESS need to consider the effect of such VAT rules on pricing strategies, data maintenance, record keeping, legal terms of use/purchase and the tax reporting required in the different jurisdictions. On this latter point, B2C suppliers of ESS that have an output VAT charge in other EU Member States have to choose whether to register for VAT in the State/s in which their customers are located or register for the Mini One-Stop Shop (MOSS) procedure in their Member State of establishment. The MOSS permits certain VAT compliance requirements to be handled through one VAT authority. The MOSS also allows non-EU entities which supply ESS to non-business customers within the EU to comply with their EU-wide VAT compliance obligations through one VAT authority.

VAT on digitised services extra-EU

While the EU has adopted a 'destination principle' on all ESS services across the board, at a global level the OECD has identified the collection of VAT on sales of digitized services to private consumers as a challenge and, in 2014, recommended that taxing rights should be allocated to the jurisdiction in which the digitized services are consumed and that customer residence should be used as proxy for consumption. Consistent with the OECD proposals, we are already experiencing that under new rules introduced in Japan, the place of taxation for digital services supplied to customers in Japan will be determined by the place of the service recipients as from 1st October 2015. Following the same path, Australia has proposed to impose a 10% Goods and Services Tax (GST) in 2017 on intangibles supplied into Australia by non-residents to end customers.

For further information kindly contact:

Anthony Pace
Partner, Tax Services
T: +356 2563 1137
E: anthonypace@kpmg.com.mt

Doreen Fenech
Partner, Tax Services
T: +356 2563 1017
E: doreenfenech@kpmg.com.mt

Juanita Brockdorff
Partner, Tax Services
T: +356 2563 1029
E: juanitabrockdorff@kpmg.com.mt

Graziella Demanuele Bianco
Senior Manager, Tax Services
T: +356 2563 1032
E: gdemanuelebianco@kpmg.com.mt

Russell Mifsud
Senior Manager, Gaming Specialist
T: +356 2563 1044
E: russellmifsud@kpmg.com.mt

Printed in Malta.
February 2016