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**EXPERT GROUP ON
TAXATION OF THE DIGITAL ECONOMY**

Working Paper on VAT issues

Meeting to be held on 14-15 January 2014

Berlaymont Building
rue de la Loi 200, 1049 Brussels



WORKING PAPER ON VAT ISSUES

Subject: Follow up of the 1st meeting of the Commission Expert Group on Taxation of the digital economy

1. INTRODUCTION AND BACKGROUND

During its first meeting held on 12 December 2013, the Expert Group noted a strong interest in addressing VAT issues related to the digital economy both with a view to making life easier for businesses (especially SMEs) and consumers as well as to safeguard tax collection. In particular, the experience with the Mini One Stop Shop (MOSS) to be implemented as from 2015 was considered as possibly providing opportunities in that respect. It could prove a workable concept on a wider scale.

It is essential to provide a level playing field to businesses involved, as well as maintaining or improving a business friendly tax framework for the digital economy. The role of start-ups and young, innovative companies is indeed crucial.

Ensuring that VAT is fully effective for e-commerce transactions presents challenges.

It should however first be clarified what we understand, from a VAT perspective, by "e-commerce". A distinction here needs to be made between:

- supply of electronic services¹
- supply of goods ordered on line.

The VAT treatment depends on the type of supply.

That issue is of major economic importance. It should indeed be reminded here that in 2010, 40 % of consumers in the EU had purchased on-line (25 % of businesses)², and that electronic commerce represented in 2009 up to 7 % of the GDP³ in certain Member

¹ The reference to electronic services is in this context taken to cover telecommunications, broadcasting and electronically supplied services.

² Source: Eurostat.

³ Source: Boston consulting group. MSs with the highest rates are UK and Sweden.

States (expected to reach 10 % in 2015). It should also be recalled that according to a study carried out in 2011, the price was seen by 66 % of online shoppers as a decisive factor when purchasing online⁴, which explains why any distortion of competition between similar products based on VAT rates may have implications.

2. NEW RULES ON SUPPLY OF ELECTRONIC SERVICES IN 2015 - PLACE OF SUPPLY AND MINI ONE STOP SHOP (MOSS)

2.1. Why and when were such rules introduced?

Currently, the VAT treatment of these services differs between supplies intra-EU and supplies to and from third countries. Taxation of electronic services supplied B2C within the EU is in the Member State in which the supplier is established and not at destination, while in relation with third countries, taxation in the Member State of destination is already the rule.

In January 2015 the place of supply of all services of telecommunications, broadcasting and electronic services to private individuals will be the Member State in which the customer is located, rather than the Member State in which the supplier is established. The same principle will apply, intra EU and in relations with third countries.

This change is a consequence of the adoption of the ‘VAT Package’ in 2008⁵, which itself was the result of long negotiations between the Member States. The changes bring the VAT treatment of these services in line with one of the main principles of VAT, in that, as a consumption tax, it accrues to the Member State in which the goods or services are consumed. This change was decided because the current rules have led to a cluster of businesses establishing themselves in Member States with the lowest rate of VAT, from which they can supply electronic services across the EU at a more advantageous VAT rate than a business established in the Member State of the customer.

Taxation in the jurisdiction of the recipient of the services is fully in line with international standards in this field. The EU indeed became in 2003 the first tax jurisdiction to tax electronic services in line with the principles developed by the Organisation for Economic Co-operation and Development (OECD)⁶. The OECD principles on the taxation of e-commerce were agreed in 1998 in Ottawa and provide that when applied, consumption taxes (like VAT) should result in taxation where consumption takes place.

⁴ Source: Civic Consulting, consumer market study on the functioning of ecommerce.

⁵ Council Directive 2008/8/EC of 12 February 2008 amending Directive 2006/112/EC as regards the place of supply of services (OJ L 44, 20.2.2008, p. 11) and Council Regulation (EU) No 904/2010 of 7 October 2010 on administrative cooperation and combatting fraud in the field of value added tax (recast) (OJ L 268, 12.10.2010, p. 1)

⁶ Ottawa Taxation Framework Conditions for e-commerce at <http://www.oecd.org/dataoecd/45/19/20499630.pdf>

2.2. How will it work in practice?

A mini One Stop Shop (MOSS) will be introduced at the same time as a simplification measure. It will allow the supplier, rather than register for VAT in each Member State in which he has a customer, to register, declare and pay the VAT due on supplies of electronic services supplied to final consumers in other Member States via a web portal in his own Member State. He will therefore submit, once a quarter, a single VAT declaration to his home administration.

With a view to prepare the changes in 2015, a Council Regulation relating to the obligations under the MOSS was adopted in October 2012⁷, along with a Commission Regulation relating to the standard forms and returns⁸. In addition, the functional and technical specifications of the system (i.e. precise details of how the Member States should implement their I.T. systems) have been adopted by the Standing Committee on Administrative Cooperation (SCAC) and on that basis, the Member States are well underway in the development of their necessary I.T framework.

In addition, a further Council Regulation, laying down measures which deal with issues such as how to determine customer location, and providing for a number of proxies to be used when determining the place of supply of certain specific services, has been adopted by the Council on 7 October 2013⁹. In particular, it clarifies the issue of customers having multiple locations, or using their devices to buy electronic services, telecommunications or broadcasting in a Member State in which they are not established.

Based on this new legal framework, clear and very detailed definitions of electronic services, broadcasting services and telecommunication services will also be available.

Furthermore, the Commission services have drafted a comprehensive Guide to the MOSS, which has been adopted by the SCAC in October¹⁰. This Guide gives detailed information on how the MOSS will work in practice.

The Commission services are currently preparing further explanatory notes on the practical implications of the changes to the place of supply rules.

In this respect, a FISCALIS workshop was organised in the Netherlands on 25 until 27 November in order to discuss, together with businesses and administrations these draft explanatory notes. The objective was to examine and clarify various concrete questions/cases, so that the same understanding can be created for all the stakeholders.

⁷ Council Regulation (EU) No 967/2012 of 9 October 2012 amending Implementing Regulation (EU) 282/2011 as regards the special schemes for non-established taxable persons supplying telecommunications services, broadcasting services or electronic services to non-taxable persons (OJ L 290, 20/10/2012, p. 1–7)

⁸ Commission Implementing Regulation (EU) No 815/2012 of 13 September 2012 laying down detailed rules for the application of Council Regulation 904/2010, as regards special schemes for non-established taxable persons supplying telecommunications, broadcasting or electronic services to non-taxable persons (OJ L 249, 14/09/2012, p. 3–10)

⁹ Council Implementing Regulation (EU) No 1042/2013 of 7 October 2013 amending Implementing Regulation (EU) No 282/2011 as regards the place of supply of services (OJ L 284, 26.10.2013, p. 1).

¹⁰ The Commission has published the [guidelines](#)  in English on 29 October 2013. They will be translated into other EU languages end of January, as well as in Chinese, Japanese and Russian languages.

The Commission's services are currently preparing a revised version of the draft explanatory notes discussed in the workshop, taking into account the remarks made during the workshop. The revised document will be discussed during the second half of February with the businesses during an ad hoc meeting in Brussels and with the Member States in the VAT Committee. Once finalised, the final explanatory notes are expected to be published on the Commission's website in March/April 2014.

Both sets of notes are widely anticipated by all stakeholders and will help businesses and tax administrations to prepare themselves for the upcoming changes in 2015.

3. SUPPLY OF GOODS ORDERED ON LINE

3.1. Goods ordered within the EU

Taxation in the Member State of destination is already the rule for the B2C online sale of goods. The VAT rate is indeed determined based on the place to which the goods are actually sent to the customer.

This is the case when the turnover of the supplier in that Member State is above a certain threshold (EUR 100 000 or EUR 35 000, depending on the Member State of destination concerned¹¹), at which point the seller must identify for VAT in the Member State of the customer. Businesses can also opt to do so even if this threshold is not reached.

This implies that, in the case of some online retailers, especially those that sell large volumes of goods, the final VAT-inclusive retail price will include different VAT rates depending on the place where the goods are sent to the customer. The rates of VAT in the EU Member States can differ from 15% to as much as 27%. This means that although businesses may establish non-discriminatory equal ex-VAT pricing for their goods across the EU, where comparisons are made between prices that are inclusive of VAT, the differences in VAT rates will make the price differences visible to the customer.

It also implies that the sellers have to register for VAT in each and every Member State where they supply such goods. The Commission proposed in 2004 to offer the facility of a One Stop Shop to those businesses but Council has until now failed to agree on such a business facilitation measure. Based on the evaluation of the MOSS for electronic services, the Commission intends to propose again such facilitation for online distance sales of goods.

3.2. Goods ordered in a third country

Goods ordered in a third country are subject to importation rules. VAT on such goods is collected at the customs office of entry into the EU, at the rate applicable in the Member State of importation.

However, the VAT Directive provides, mainly to ease the burden on customs administrations, for a VAT exemption on the importation of small commercial consignments. These are the goods not exceeding the threshold set by each Member State at an amount which shall be between EUR 10 and 22. Member States may exclude goods which have been imported by mail order (online) from this exemption. In any situation,

¹¹ Threshold: see http://ec.europa.eu/taxation_customs/taxation/vat/traders/vat_community/index_en.htm

exemption does not apply for imported consignments of alcoholic products, perfumes and toilet waters and tobacco and tobacco products.

This special exemption, which has been enshrined in EU VAT Law at a time where e-commerce did not exist, is now generating distortions of competition, because third country exporters of small value goods (CD, DVD or magazines e.g.) are advantaged compared to EU supplies (see paragraph 3.1). This is notably the case with those third countries or third territories (parts of the VAT which are outside the VAT territory) which are very close.

Such exemption could in future be lifted if simplified collection mechanisms (e.g. through a One Stop Shop or through a simplified customs declaration) could be put in place.

4. MAIN EMERGING ISSUES - ORIENTATIONS FOR FUTURE WORK

The main issue that arises for the EU VAT system is to ensure that tax on e-commerce accrues to and is collected by the jurisdiction competent to impose indirect taxation. Collection of tax from suppliers who are not established in the Member State where the tax is due deserves particular attention.

4.1. The new rules applicable as of 2015 – need to make them workable

The implementation and smooth application of taxation at destination of electronic services is an excellent test for the application of the principle of taxation at destination in the future¹². In this respect, a well-functioning MOSS is an essential stone. Based on the experience that will be gathered as from 2015, further extension should be envisaged.

4.2. Need to further improve the legislation on distance sales of goods

First there is clear need to offer a One Stop Shop to EU online suppliers of goods for which there is today, based on the principle of taxation in the Member State of consumption, a need to register and pay VAT in all countries where they have customers. This was already proposed by the Commission in 2004, and has been supported by the High Level Group on administrative burdens chaired by Dr Stoiber. Further work will be needed here after the entry into force of the MOSS for electronic services. VAT is indeed seen as the biggest burden by these companies and is a clear obstacle to cross border trade.

In the relations with third countries, the problem is different. The issue here is the distortion of competition generated by the different treatment of small consignments. Indeed, there is currently a VAT exemption at importation of small consignments that creates distortions of competition, as the same goods supplied within the EU are charged with VAT. A simplified VAT collection mechanism (through e.g. a One Stop or a simplified customs declaration) would help here as an alternative to the current exemption. A study is on-going on this issue in order to precisely assess the impact of the current legislation.

¹² COM(2011) 851 final on the future of VAT

4.3. Need to improve the enforcement of the current legislation

The main challenge in relation to non-EU suppliers is to ensure these suppliers respect EU tax collection obligations. This market has theretofore been generally seen as dominated by a small number of relatively high-profile suppliers. It is not clear that this remains the case and certainly the newer generations of e-commerce customers are less likely to be constrained by factors such as reputation and name recognition.

A further dimension to this challenge comes from the continued evolution of e-commerce. New technologies (including mobile e-commerce) and new business models (such as online auction houses and new patterns of intermediation)¹³ have an effect on the ability of tax administrations to ensure that obligations are respected.

Other than the risk of tax losses, non-compliance has negative consequences for tax compliant businesses facing unfair competition.

Work in the OECD on Base Erosion and Profit Shifting addresses inter alia the issue of collecting VAT in the global digital economy. Although this is well supported, it is by no means certain that it will lead to a global agreement on the steps to be taken to secure tax collection. Given the importance of VAT as a revenue source for Member States, the EU cannot wait to see for such solutions to be agreed at an international level.

The EU should therefore start negotiations on bilateral agreements with key trade partners (USA, China, Russian, Norway...). First steps have been taken in this field.

Also within the EU, the existence of a One Stop Shop will require more coordination of audits. Not all Member States today agree on the need within the mini One Stop to give a coordination role to the Member State of identification, although the rules on administrative cooperation offer all the necessary tools in this respect. Further work and a stronger political impetus are needed in this area.

¹³ See for example Decision "E-Bay Canada Ltd. v. Canada (National Revenue)", November 2008 FCA 348 (CanLII).