



COMMISSION OF THE EUROPEAN COMMUNITIES

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Proposal for a

COUNCIL DIRECTIVE

amending directive 2002/38/EC

as regards the period of application of the value added tax arrangements applicable to radio and television broadcasting services and certain electronically supplied services

REPORT FROM THE COMMISSION TO THE COUNCIL

on COUNCIL DIRECTIVE 2002/38/EC of 7 May 2002

amending and amending temporarily Directive 77/388/EEC as regards the value added tax arrangements applicable to radio and television broadcasting services and certain electronically supplied services

(presented by the Commission)

EXPLANATORY MEMORANDUM

CONTEXT OF THE PROPOSAL

- **Grounds for and objectives of the proposal**

Council Directive 2002/38/EC of 7 May 2002 amending and amending temporarily Directive 77/388/EEC as regards the value added tax arrangements applicable to radio and television broadcasting services and certain electronically supplied services, the so called e-commerce VAT Directive, contains a number of provisions which are due to expire on 30 June 2006 unless extended.

When enacted, it was intended that the provisions covering the place of supply of these services and certain facilitation measures for non-EU businesses should be reviewed by the Council before the end of the first three years of operation and, on the basis of a proposal from the Commission, revised or extended as needed. The review is on the basis of a report from the Commission to the Council and this report is accordingly adjoined to this proposal. The timely adoption by the Council of proposals from the Commission on the place of supply of services (COM (2005) 334) and on the simplification of VAT obligations (COM (2004) 728) would have obviated the need to extend the provisions in question since these more general proposals included measures to ensure the long term fulfilment of the aims of Directive 2002/38/EC. The slow rate of legislative progress by Member States in the Council however means that these changes will not be in place in time before the 2002 measures expire. If the provisions are not to expire this year - an outcome which nobody would welcome - the Commission has no choice but to propose their temporary extension.

The main objective of Directive 2002/38/EC was precise - rectifying an obvious shortcoming in one of the basic provisions of VAT law. Electronic delivery of services had not been foreseen at the time the 6th VAT Directive was enacted and the application of the provisions as they stood prior to the 2002 changes gave a perverse result. Not only did they fail to tax electronic services provided by third country operators but European businesses were obliged to tax all such supplies - regardless of where the customer was located. This outcome conflicted with the neutrality which is central to VAT and seeks that the tax does not "distort conditions of competition or hinder the free movement of goods and services" (First Council Directive on VAT 67/227/EEC).

The issue was *where* these services should be taxed. VAT is a general tax on the consumption of goods and services and any exclusion requires a specific provision. If developments in technology or commercial practices produce lacunae in the coverage, it has always been standard practice to rectify them

The Directive 2002/38/EC included simplified registration and reporting obligations to assist compliance by non-EU operators, allowing them to deal with a single European tax administration of their choice. This provision was a significant departure from the existing norm where taxpayers are required to deal directly with each administration in whose jurisdiction taxable activities took place. Although limited in coverage to non-established e-commerce service suppliers, the novel nature of this single point for VAT compliance was a contributory factor to the insertion of a review clause which obliged

the Commission and Member States to re-visit the issue before the end of three years. The report from the Commission to the Council concludes that the 2002 Directive has operated in a satisfactory manner and has achieved its objective. In the absence of a decision on renewal or replacement, its main provisions would expire and the rules for e-services would revert to those prevailing prior to the changes effected from 2003. In order to avoid such a situation, the Commission is therefore proposing that the existing provisions which are set to expire this year should be extended by a period of 30 months until 31 December 2008. This will allow sufficient time for the adoption of the two proposals mentioned above and for Member States to ensure that the infrastructural changes necessary are in place.

This proposal will also ensure that the provisions of Council Regulation (EC) No 1798/2003 which deal with the exchange of information between Member States needed for registering foreign e-service traders for VAT purposes and for distributing the VAT receipts to the appropriate Member State, will remain in force as this is linked to Directive 2002/38/EC.

- **General context**

Council Directive 2002/38/EC was introduced with the primary aim of eliminating an undesired and unintended effect of the 6th VAT Directive whereby EU businesses found themselves charging and collecting VAT in circumstances which placed them at a competitive disadvantage vis-à-vis 3rd country based operations.

The Directive has delivered on this objective. Today the balance between EU and non-EU operators is not a problem as far as VAT is concerned and nobody would wish to revert to the position which existed prior to its adoption.

Although not the primary objective, the Directive has contributed to the tax receipts of Member States. In addition to tax collected and paid by non-EU operators registered under the special scheme, the amounts accounted for by businesses which opted for establishment within the Community are likely to be significant. The total is however difficult to quantify as companies opt to set up in the EU for a variety of reasons and it is not practical to identify VAT receipts from the particular services covered by the Directive with precision in published revenue statistics. A further effect on tax revenue is attributable to VAT from existing EU businesses who, with the adoption of the Directive, no longer had any incentive to move their operations outside the Community to protect their competitive position. The combined effect of these three factors confirms the case for extending the provisions

During the last three years, the market for B2C downloads and on-line services has matured and become more sophisticated over the time since the Directive was adopted. According to the IFPI, the music industry's global trade body, sales of digitally distributed music tripled during 2005. Regulatory and legal issues such as for instance those associated with rights management and illegal downloads are in the process of being resolved. Uncertainty about future tax treatment would be a backward step and which can only be removed through this prolongation measure.

In addition to creating uncertainty, failure to extend the measures would re-awaken the concerns about displacement of business activity which were a major driver in the

changes adopted in 2002.

- **Existing provisions in the area of the proposal**

This is a simple extension of the existing Directive 2002/38/EC. In time the provisions which expire this year will be given permanent effect by the adoption of the two proposals already mentioned, COM (2004) 728 and COM (2005) 334. These are measures which deal respectively with the simplification of administrative obligations and the place of taxation of services in general. Largely because of their very broad scope, legislative progress has been slower than expected. Nevertheless, they are likely to be adopted in the near future but not in time to cover the expiry of the provisions in the 2002 Directive.

Taken together, these two proposed measures will ensure the correct long term functioning of the application of VAT to e-services in line with the goals set out in Article 5 of Directive 2002/38/EC.

- **Consistency with the other policies and objectives of the Union**

The provisions whose extension is being proposed are fully in line with established EU VAT policy as set out in the 6th VAT Directive. The original 2002 Directive was occasioned by a lacuna in the coverage of the 6th Directive caused by technological change and the need to assure consistent application of the tax.

2) CONSULTATION OF INTERESTED PARTIES AND IMPACT ASSESSMENT

- **Consultation of interested parties**

Consultation methods, main sectors targeted and general profile of respondents

Participants in two seminars in the Fiscalis Programme held during the last three years to monitor the operation of the 2002 Directive included representatives of all Member States and representatives of a majority of the operators involved.

Summary of responses and how they have been taken into account

Because of the sensitive nature of the relationship between taxpayers and tax administrations, it is not appropriate to identify individual contributions to this dialogue. All significant issues raised are however addressed in the Report from the Commission to the Council.

- **Collection and use of expertise**

There was no need for external expertise.

- **Impact assessment**

The only other option open to the Commission would have been to allow the 2002 provisions to lapse.

The reasons why this was not a realistic option are set out in the Report from the Commission to the Council.

3) LEGAL ELEMENTS OF THE PROPOSAL

- **Summary of the proposed action**

The proposal will extend the period of application foreseen in Article 1 of Council Directive 2002/38/EC thereby ensuring that the measures adopted for the correct taxation of certain electronically supplied services and radio and television broadcasting services remain in place.

- **Legal basis**

Article 93 of the Treaty and Council Directive 2002/38/EC

- **Subsidiarity principle**

The proposal falls under the exclusive competence of the Community. The subsidiarity principle therefore does not apply.

- **Proportionality principle**

The proposal complies with the proportionality principle for the following reason(s).

The Proposal is a simple extension of the period of application of an existing measure in the 6th VAT Directive. There is no other reasonable alternative.

The measures adopted in 2002 have worked satisfactorily for both Member States and the businesses concerned. There is no alternative option which would better achieve the objectives of the original measure.

- **Choice of instruments**

Proposed instruments: directive.

Other means would not be adequate for the following reason(s).

This Proposal extend the period of application of a provision already enacted in a Directive. There is no alternative means to achieve this objective.

4) BUDGETARY IMPLICATION

The proposal has no quantifiable implication for the Community budget.

5) ADDITIONAL INFORMATION

- **Review/revision/sunset clause**

The proposal includes a revision clause.

- **Correlation table**

The Member States are required to communicate to the Commission the text of national provisions transposing the Directive as well as a correlation table between those provisions and this Directive.

Proposal for a

COUNCIL DIRECTIVE

**amending directive 2002/38/EC
as regards the period of application of the value added tax arrangements applicable to
radio and television broadcasting services and certain electronically supplied services**

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 93 thereof,

Having regard to the proposal from the Commission¹,

Having regard to the opinion of the European Parliament²,

Having regard to the opinion of the European Economic and Social Committee³,

Whereas:

- (1) The review provided for in Article 5 of Council Directive 2002/38/EC of 7 May 2002 amending and amending temporarily Directive 77/388/EEC as regards the value added tax arrangements applicable for radio and television broadcasting services and certain electronically supplied services has been carried out.
- (2) In the light of that review, it is appropriate that, in the interests of the proper functioning of the internal market and in order to ensure the continued elimination of distortion, the value added tax arrangements applicable to radio and television broadcasting services and certain electronically supplied services should continue to apply until 31 December 2008.
- (3) Directive 2002/38/EC should therefore be amended accordingly,

HAS ADOPTED THIS DIRECTIVE:

Article 1

Article 4 of Directive 2002/38/EC shall be replaced by the following:

'Article 1 shall apply until 31 December 2008.'

¹ OJ C , , p. .
² OJ C , , p. .
³ OJ C , , p. .

Article 2

1. Member States shall adopt and publish, by 30 June 2006 at the latest, the laws, regulations and administrative provisions necessary to comply with this Directive. They shall forthwith communicate to the Commission the text of those provisions and a correlation table between those provisions and this Directive.

They shall apply those provisions from 1 July 2006.

When Member States adopt those provisions, they shall contain a reference to this Directive or be accompanied by such a reference on the occasion of their official publication. Member States shall determine how such reference is to be made.

2. Member States shall communicate to the Commission the text of the main provisions of national law which they adopt in the field covered by this Directive.

Article 3

This Directive shall enter into force on the day following that of its publication in the *Official Journal of the European Union*.

Article 4

This Directive is addressed to the Member States.

Done at Brussels,

*For the Council
The President*

REPORT FROM THE COMMISSION TO THE COUNCIL

on COUNCIL DIRECTIVE 2002/38/EC of 7 May 2002 amending and amending temporarily Directive 77/388/EEC as regards the value added tax arrangements applicable to radio and television broadcasting services and certain electronically supplied services

1. BACKGROUND

Directive 2002/38/EC requires the Commission to make a report by 30 June 2006 on its operation and, if needed, to propose either changing the way it operates or to extend its applicability. This report responds to the first obligation. The Commission is also proposing to extend the application of the Directive to the end of 2008. To avoid duplication with the Explanatory Memorandum to the extension proposal, the report concentrates on the practical impact of the Directive and how it works in practice.

The 2002 measures meant that the EU became the first tax jurisdiction to tax e-services in line with the principles developed by the Organisation for Economic Co-operation and Development⁴. 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.

This review looks at the services covered by the Directive and the practical questions in the administration of the tax as well as its longer term operational framework.

2. SCOPE OF THE REPORT

2.1. E-services

The electronically supplied services covered by the Directive in Annex L are described as an “illustrative list of electronically supplied services referred to in Article 9.2.(e)” and mentions the following examples:

Website supply, web-hosting, distance maintenance of programs and equipment.

Supply of software and updating thereof.

Supply of images, text and information, and making of databases available.

Supply of music, films and games, including games chance and gambling games, and of political, cultural, artistic, sporting, scientific and entertainment broadcasts and events.

⁴ Ottawa Taxation Framework Conditions for e-commerce at <http://www.oecd.org/dataoecd/45/19/20499630.pdf>

Supply of distance teaching.

Annex L goes on to add that simply communicating by email does not of itself create an electronically supplied service.

If the illustrations seem less than definitive, this should be balanced against the need to be sufficiently broad to take account of possible innovation in the range of e-commerce services.

This part of the text was augmented by guidelines of the VAT Committee which were eventually implemented as part of a Council Regulation⁵.

This approach has worked well in ensuring that the services in question are clearly identified. New developments have not given rise to any concerns and no further measures are needed at this stage.

2.2. Broadcasting

As well as addressing e-services, the Directive also changed the place of taxation for radio and television broadcasting. The special measures for non-established e-service operators do not apply here and non-established broadcasters must register in each Member State where they have taxable activities.

Although definition for broadcasting has not given rise to problems, any distinction from the wider category of e-services has blurred over recent years. The growth of podcasting, video-on-demand, streaming and digital broadcasting means that content can be accessed in several ways. Delivery of similar content can be made via internet, over interactive and traditional broadcasting networks or via 3G networks.

It will be increasingly difficult to justify differences in tax treatment as broadcasting, telecommunications and e-services converge. References to broadcasting in the Sixth Directive reflect the intention of legislators at a time of simpler technology. Apart from the consequential competitive imbalance which is likely to increase over time, it is hard to see how the increasingly sophisticated applications now evolving match the intent of legislators at a time when the reception of broadcasting services was a much simpler, perhaps even a localised⁶ service.

The evolution of technology and the rapid acceptance of new channels of distribution over the last 3 years raise new issues which the Directive did not address. The Commission will not however consider whether these implications need to be addressed in legislation before looking at the issue in greater depth.

⁵ Council Regulation (EC) No 1777/2005 of 17 October 2005 laying down implementing measures for Directive 77/388/EEC on the common system of Value Added Tax. O.J. 29.10.2005 L 288 p. .1.

⁶ The inclusion of the reception of broadcasting services in the same indent as "admissions to shows, theatres, circuses, fairs, amusement parks" etc., would seem to confirm this.

3. PRACTICAL ADMINISTRATION OF THE TAX

The 2002 Directive was an innovative measure in providing special measures for non-resident operators. It introduced here new concepts and procedures in collection of VAT. These innovations had an impact on businesses as well as tax administrations. There were in addition concerns that the technology and protocols at the heart of e-commerce might prove incompatible with tax collection, even putting in question the viability of VAT as a general tax on all consumption of goods and services.

As experience has shown, these concerns were without foundation and the system gives rise to little operational difficulty on a day-to-day basis. This indeed would have to be an essential pre-condition its continuation in an un-altered form.

Because of the many novel aspects of the tax, its detailed implementation needed special attention. The Commission services worked closely with tax administrations and other stakeholders. In addition to two Fiscalis seminars, this involved contacts were with a number of commercial actors including professional advisors and infrastructure providers. The Commission services also worked with the OECD on e-commerce tax issues, in particular on guidelines for determining the place of consumption.

This has proven a useful in considering the working of the Directive and identifying potential difficulties. In terms of the overall functioning of the provisions, they have delivered on their objectives and that there is no pressing need to change the legislation beyond extending its period of application. On the other hand, aspects of detailed implementation were difficult to foresee and it is unsurprising that here there are some issues requiring mention in the context of a general review.

The Commission organised two Fiscalis seminars to help the process. The first focused on assisting Member States in introducing and operating the new provisions. The second seminar, in 2004, looked at how they were functioning and sought to identify operational issues which might cause difficulties. At both speakers from business and from agencies concerned with other regulatory aspects of e-commerce made valuable contributions.

3.1. Link with One Stop Scheme

For the Commission and for Member States, it was soon clear that the new single point of identification not only worked well for e-services but was a promising model for dealing with a number of aspects of intra-Community trade where difficulties had been identified. This was the genesis of the One Stop Scheme (OSS) and which formed the core of a wide ranging proposal to simplify VAT obligations⁷. This

⁷ COM(2004)728. Proposal for a Council Directive amending Directive 77/388/EEC with a view to simplifying value added tax obligations; Proposal for a Council Directive laying down detailed rules for the refund of value added tax, provided for in Directive 77/388/EEC, to taxable persons not established in the territory of the country but established in another Member State; Proposal for a Council Regulation amending Regulation (EC) No 1798/2003 as regards the introduction of administrative cooperation arrangements in the context of the one-stop scheme and the refund procedure for value added tax.

envisages a far wider area of application than the very specific one covered by the e-commerce services scheme.

Not all aspects e-commerce services scheme were seen as scaleable for a significantly larger platform. The proposed OSS model differs in certain aspects, in particular in the manner in which tax payments are handled, although for most purposes will be broadly similar.

The volume of activity handled by the OSS will be larger by a significant multiple than the e-commerce services scheme. It would be inefficient to keep both schemes operating and the intention is that the OSS will absorb the e-commerce scheme.

The proposal for the OSS indicated a start date of 1 July 2006, which dove-tailed with the expiry of the e-services Directive. However progress in the Council is far slower than the Commission could have imagined. This applies also to the proposal on the place of supply of services⁸ where implementation was also foreseen for 1 July 2006, allowing for the continuity of the current rules in Directive 2002/38/EEC on the place of consumption.

Until these changes are in place, the existing special scheme and rules on the place of taxation will have to be extended. Moreover, if the provisions are not renewed, the original problematic taxing issues would resurface. The 2003 changes are now well settled and present little problem to the industry. A disruptive change in the tax regime, such as a reversion to the pre-2003 situation, would not be a welcome move at this time, neither for operators nor for tax administrations.

3.2. Day-to-day operational issues

When the Directive was implemented, concerns were expressed about the administrative and compliance difficulties for non-European companies selling e-services into the Community. Time has shown that these were not as burdensome as some at first envisaged.

For most non-European companies the changes did not lead to any compliance obligations. B2B accounts for the greater part of on-line e-services and here compliance is a matter for the European customer. The business receiving these services has to account for the VAT to its home tax administration.

It is only when the non-European company delivers supplies to non-business or final customers in the EU that tax obligations commence. Determining whether the customer is a business or not is generally a verifiable question of fact and, on the basis of the information received does not seem to have posed any significant problem other than in isolated instances.

A non-EU company with the obligation to collect and remit tax under the Directive has three options for achieving compliance. The *first* would be to establish in a Member State. Effectively this would mean operating on the same basis as a European business and, for a significant number of operators, seems to have been the

⁸ COM(2005)334. Amended proposal for a Council Directive amending Directive 77/388/EEC as regards the place of supply of services.

most attractive choice. This may well have been motivated by the attraction of the applicable rate of VAT, but equally some companies appear to have chosen their place of establishment on the basis of other non-VAT reasons.

The *second* option under existing provisions for non-established operators, would have been to register in each Member State where the operator has taxable activities but without creating an establishment. There was little indication of significant take-up under this heading. In all likelihood, the prospect of up to 25 registrations and an equivalent number of different obligations was seen as unattractive.

To avoid an unreasonable burden on 3rd country businesses, the Directive provided a *third* option allowing for a single registration with a selected “Member State of identification” using innovative simplified arrangements. VAT is then charged and collected according to the standard rate of tax of the customer's the Member State. Finally, these collected taxes should be paid to the tax administration of identification together with a return in a standard format showing the details of taxable activities over the different Member States. Independently, a system was also put in place to ensure that the right share of tax revenue and the data needed for confirmation purposes was channelled to the appropriate Member State⁹. Administratively, this put non-established operators in a comparable position to an established taxable person dealing with only one tax administration.

3.3. Determining place of taxation

Some evidence has been adduced in relation to the potential for conflict between proxies used for the place of taxation (the place where the customer is established under the Directive) and a strict interpretation of the place of actual consumption. A billing address is usually a dependable indication of place of consumption but may not always give the correct result under a pure test of consumption. As the services covered by the Directive become increasingly mobile this may become a more significant issue. In certain circumstances the outcome could impinge on the taxing rights of non-EU countries which would be at odds with the intent of the Directive. When the place of actual consumption is located in a non-EU country, issues arise on conformity with the OECD principles as well as ECJ case law on the territorial limitations of the Directive (e.g., *Trans Tirreno Express v Ufficio Provinciale Iva* C-283/84 as well as *Kohler v Finanzamt Dusseldorf-Nord* C-58/04).

There is currently no Community guidance on an acceptable method of verification, particularly where alternatives exist. There may be a case for some form of guidance on verifying the location of customers, particularly where an operator acts in good faith, but before that some confirmation of how significant the problem is would be needed. Article 29a of the Sixth Directive allows the Council to adopt implementing measures and might then be an appropriate instrument if justified.

⁹ Council Regulation (EC) No 1798/2003 of 7 October 2003 amending temporarily Regulation (EEC) No 218/92 on administrative cooperation in the field of indirect taxation (VAT) as regards additional measures regarding electronic commerce OJ L 264, 15.10.2003, p. 1

3.4. Geographical segmentation

Although e-commerce is widely seen as a borderless activity, there are in reality many examples of where an international operator segregates customers on a geographic basis. This may be for several reasons including commercial objectives, copyright restrictions or other regulatory obligations. It may also make it easier for the operator to deal with EU VAT issues.

Where a customer accessing the website is detected as coming from an EU location (perhaps on the basis of geo-location software), they are automatically directed to the EU site where VAT obligations are a part of the normal transaction procedures. In the overwhelming majority of cases this functions without problems and has the advantage of ensuring that sales to EU based customers are handled in the correct manner for VAT since they are isolated from other business.

It is not particularly easy to circumvent these systems but it can be achieved with some determination and knowledge. The motivation may be increased choice or better prices (which may not necessarily be attributable to VAT) or simple perversity. Whatever the reason, the result is that an EU consumer acquires a taxable service from a source that is not geared towards handling EU transactions. There is no evidence that this is a widespread phenomenon but it may cause difficulties for an otherwise compliant taxpayer.

The absence of a threshold in the Directive means that tax exposure can arise from a single transaction. It is hard for an operator to identify such "spill-over" transactions in real time and they may subsequently find themselves liable. The result is one which could not have been reasonably foreseen at the time the Directive was introduced and for which there is no proper provision.

For practical reasons tax administration should be encouraged to see these occasional or unintended transactions for what they are and, as long as they remain such, to be handled in the context of materiality and proportionality. If deemed necessary, in order to ensure conformity and consistency, the correct treatment could be considered by the VAT Committee and, where appropriate, confirmed by the use of Article 29a.

3.5. Taxable status of customer

Verifying the taxable status of the customer is central to any taxing decision and the Directive does not give any guidance on how an operator should make this distinction. In this respect the provision of electronically supplied services is generally no different to any other taxable transaction and the seller must make a choice on the basis of all available information. The one aspect where these services are unique is in the almost instantaneous nature of most e-service transactions where there is little time to reflect on a decision or to adjust it retrospectively.

Some operators have expressed the view that they should be permitted to make a distinction solely on the basis of information which can be verified in real time against the VAT Information Exchange System (VIES) database. Although this may seem superficially reasonable, there are a number of drawbacks. Whilst VIES is an on-line service which permits the instantaneous confirmation of the validity of a

customer's VAT identification number, it can never be expected to function as a definitive guide to taxable status. It is merely one element in a wider process. For the moment however VIES provides a tool for identifying a business and the absence of a verifiable VAT number is, in most cases, a *prima facie* indication that the supplier is not dealing with a taxable operator. The Commission will continue to work on upgrading the quality and functionality of VIES. Most recently, it has been extended to handle batch verification requests in response to demands from business.

Nevertheless, there may be a case for some clarity and consistency in what level of verification is acceptable for on-line transactions generally. Some Member States already accept that for real-time transactions of low value, a simple declaration from the customer suffices but this may not be acceptable to all administrations.

This is an issue which needs further consideration, particularly if evidence can be adduced that for electronically supplied services, special considerations arise.

3.6. Issues of equivalence

There has, as already said, been expansion in the commercial activities covered by the Directive. In some cases this has been via organic growth where new applications are readily accepted by the market. In others it has come via transition from traditional to digital media. For the publishing industries, the effects are likely to both significant and long term.

This industry has benefited from the reduced VAT rate provisions in Annex H of the Sixth Directive for printed material. The benefits of this measure are widely appreciated and generally seen as a sustainable contribution to wider public policy objectives. When the 2002 Directive was debated, the issue frequently arose as to whether some equivalent measure could apply to on-line publishing on grounds of neutrality between different channels of distribution. However the very nature of the shift towards digitalisation would present numerous impediments. Electronic publication opens the door to range of functionalities which give a service increasingly removed from traditional printing and rather in the mainstream of general electronic communication and distribution. It would be futile to try to identify and isolate, for special tax treatment, a category of on-line content with a direct equivalence to printed material.

Digitalisation is going to continue and the industry faces a period of transition. Newspaper readership continues to decline and even advertising revenue stagnates as on-line resources develop. The contents of books are easily (at least technically) and widely digitised. Consumers increasingly look to digital content created only with on-line distribution in mind. The Commission's digital libraries initiative¹⁰ recognises the reality of this process and the need to address the challenges for Europe's cultural heritage and store of scientific knowledge.

It seems difficult to envisage a way in which fiscal measures might be usefully deployed here. The reduced rate facility in Annex H is not readily transposable to the

¹⁰ COM (2005) 465 final of 30.9.2005 – Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions titled "i2010 : Digital Libraries"

digital environment. There is however nothing in the move towards digitalisation that questions the continuance of a reduced VAT for printed material. Nevertheless, the reality increases non-recoverable VAT borne by institutions such as universities and libraries. Whilst aware of the issue, the Commission considers that this is not the place to address it.

3.7. Games of chance and gambling.

A significant area of growth since 2003 has been in the area of on-line gambling, gaming and betting.

In many instances this involves an on-line electronic game or electronic platform where participants place wagers with each other or play for a share of a common pot. Frequently the provider of the service is not acting as the "house" or providing a bookmaking service but rather earns revenue from a charge based on access or use. What is being offered is clearly a taxable electronically supplied service under the Directive on which VAT should be charged.

Betting and gambling services are VAT exempt under Article 13(B)(f) of the Sixth Directive but only when they fall within the conditions and limitations set by individual Member States. This allows Member States to choose the activities which they wish to exempt with the consequence that betting and gambling activities which not specifically exempted are liable to VAT. The ambit of discretion is however restricted by the principle of neutrality laid down by the ECJ in several judgements¹¹.

The place of taxation for betting and gambling supplied electronically by operators based outside the EU is the place where the consumer of the service is established and taxation is determined by the manner in which the exemption has been effected in the Member States of the consumer's establishment. When supplied by an operator established in a Member State, the place of taxation is currently the place where the operator is established and the tax treatment is determined by the way in which that Member State applies the exemption.

Where gambling transactions are not exempt, the manner in which VAT should be charged has been set down by the European Court of Justice in case C-38/93¹² which held the taxable amount to be the net receipts from the operation rather than the total amount staked. This interpretation is however based on specific elements present in this case and elsewhere¹³ the Court has expressed a different view in regard to some gaming activities.

The correct interpretation of these rulings when applied to on-line gambling and betting may need clarification, particularly where it seems that diverse treatment at the level of Member States places an undue burden on the tax compliant operator. This may need further examination, particularly if the existing rules on the place of taxation for on-line services made by an operator established in the EU change.

¹¹ E.g., Joined cases C453/02 and 462/02 *Slinneweber*) and case C-283/95 (*Fischer*).

¹² *Glawe v Finanzamt Hamburg-Barmburg-Uhlenhorst* - case C-38/93.

¹³ *Town and Country Factors Limited v Commissioners of Customs and Excise* - case C-498/99

3.8. Keeping and making available of records

For non-established operators, Article 26c.B(9) of the Sixth Directive on record keeping and access to records reflects the reality that they will not have an establishment in the EU. The normal verification and audit procedures used to check compliance are no longer relevant when a business operates from a remote location. This distancing in itself creates problems and the Directive deals with it in a fairly straightforward manner by simply requiring that they keep records in sufficient detail to back up the tax return. These records should be available electronically to the tax administrations concerned on request and should be kept for 10 years.

There has been no indication of difficulties on the part of operators in meeting these obligations. Neither have tax administrations indicated any problems in verifying the correctness of VAT returns submitted under the special scheme. A similar provision in Article 22a of the Sixth Directive allows tax administrations generally to audit records remotely. The absence of reported problems on the part of administrations should perhaps be read against the reality that there is no evidence to suggest that these provisions have yet been used on a systematic basis by Member States.

4. CONCLUSIONS

In monitoring the practical implementation of the Directive since 2003, there has been a consistent and extensive level of contact with both Member States and with many of the operators concerned. This allowed the Commission to identify any issues which might have caused concern and to monitor their evolution over time. For the most part, they have turned out to be questions of relatively minor significance or ones whose solution will be found elsewhere. Where necessary, the Commission will continue to monitor these latter concerns to ensure that they achieve a satisfactory resolution.

It can however be concluded with certainty that a failure to prolong the Directive would have major negative on all interested parties. The experience over the last three years can lead to no other judgment. The extension being proposed will allow for alignment of the special scheme for non-established operators with the more general One Stop Scheme. Some of the technical issues mentioned above are horizontal in their nature and are more properly addressed in the wider context.

In moving towards full implementation of the One Stop Scheme, the Commission will therefore continue to take account of the experiences of both administration and commercial operators in the implementation of the e-services scheme.